INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 5

ADVANCED ACCOUNTING

MODULE – 2

BOARD OF STUDIES
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This Study Material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Revised Edition	:	July, 2015
Website	:	www.icai.org
E-mail	:	bos@icai.in
Committee/ Department	:	Board of Studies
ISBN No.	:	
Price(All Modules)	:	
Published by	:	The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi 110 002, India.
Printed by	:	

CONTENTS

DETAILED CONTENTS : MODULE – 2

4

Company Accounts

Unit – 1: ESOP and Buy-back of Shares

Learning Objectives

After studying this unit, you will be able to

- Learn the provisions of the Companies Act 2013 regarding employees' stock option.
- Understand the accounting policies of employees' stock option plan.
- Learn the accounting treatment of employees' stock options.
- Learn the provisions of Guidance Note on Employee Share-Based Payments.
- Learn the provisions of the Companies Act regarding buyback of securities
- Understand equity shares with differential rights.

1.1 Employees Stock Option Plan

Under Section 62 (1) (b) of the Companies Act 2013, where at any time a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares may be offered to employees under a scheme of employees' stock option, subject to a special resolution passed by the company and subject to such conditions as may be prescribed.

Earlier Securities and Exchange Board of India (SEBI) issued Employees Stock Option Scheme and Employee Stock Purchase Scheme Guidelines (applicable for listed companies) in 1999 under section 11 of the Securities and Exchange Board of India Act, 1992. This guideline has now been replaced by the SEBI (Share Based Employee Benefits) Regulations, 2014* (applicable for listed companies). It cover the provisions regarding accounting policies, pricing, disclosures, administration and implementation process of various schemes and other issues relating to Employee Stock Option

---

* ***SEBI (Share Based Employee Benefits) Regulations, 2014 has been issued on October 28, 2014 and are applicable from the same date.***

Scheme (ESOS), Employee Stock Purchase Scheme (ESPS), Stock Appreciation Rights Scheme (SRS), General Employee Benefits Scheme (GEBS) and Retirement Benefit Scheme (RBS). The Regulation stipulate to follow the requirements of the 'Guidance Note on Accounting for Employee Share Based Payments' or Accounting Standards as may be prescribed by the ICAI from time to time including the disclosure requirements prescribed therein.

1.1.1 Important terms to be remembered

1. ***Grant***: Grant means issue of option to the employees under ESOS.
2. ***Vesting:*** It is the process by which the employee is given the right to apply for shares of the company against the option granted to him in purchase of employee in pursuance of employee stock option scheme (ESOS).
3. ***Vesting Period****:* It is the time period during which the vesting of the option granted to the employee on pursuance of ESOS takes place.
4. ***Option****:* Option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.
5. ***Exercise Period:*** It is the time period after vesting within which the employee should exercise his right to apply for shares against the option vested in him in pursuance of the ESOS.
6. ***Exercise Price:*** It is the price payable by the employee for exercising the option granted to him in pursuance of ESOS.
7. ***Intrinsic Value:*** It is the excess of the market price of the share under ESOS over the exercise price of the option (including up-front payment, if any).
8. ***Fair Value:*** It is the amount for which stock option granted or a share offered for purchase could be exchanged between knowledgeable, willing parties in an arm's length transaction.

1.1.2 Provisions of Guidance Note on Employee Share-Based Payments

Recognizing the need for establishing uniform sound accounting principles and practices for all types of share-based payments, the Accounting Standards Board of the Institute is developing an Accounting Standard covering various types of share-based payments including employee share-based payments. However, as the formulation of the Standard is likely to take some time, the Institute has decided to bring out this Guidance Note. Once the Accounting Standard dealing with Share-based Payments comes into force, this Guidance Note will automatically stand withdrawn.

This Guidance Note establishes financial accounting and reporting principles for employee

share-based payment plans, viz., employee stock option plans, employee stock purchase plans and stock appreciation rights. For the purposes of this Guidance Note, the term 'employee' includes a director of the enterprise, whether whole time or not.

For accounting purposes, employee share-based payment plans are classified into the following categories:

- Equity-settled: Under these plans, the employees receive shares.
- Cash-settled: Under these plans, the employees receive cash based on the price (or value) of the enterprise's shares.
- Employee share-based payment plans with cash alternatives: Under these plans, either the enterprise or the employee has a choice of whether the enterprise settles the payment in cash or by issue of shares.

An enterprise should recognize as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in this Guidance Note. If the shares or stock options granted vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In the absence of evidence to the contrary, the enterprise should presume that services rendered by the employee as consideration for the instruments have been received. In this case, on the grant date, the enterprise should recognize services received in full with a corresponding credit to the equity account. If the shares or stock options granted do not vest until the employee completes a specified period of service, the enterprise should presume that the services to be rendered by the employee as consideration for those instruments will be received in the future, during the vesting period. The enterprise should account for those services as they are rendered by the employee during the vesting period, on a time proportion basis, with a corresponding credit to the equity account.

An enterprise should measure the fair value of shares or stock options granted at the grant date, based on market prices if available, taking into account the terms and conditions upon which those shares or stock options were granted. If market prices are not available, the enterprise should estimate the fair value of the instruments granted using a valuation technique to estimate what the price of those instruments would have been on the grant date in an arm's length transaction between knowledgeable, willing parties. The valuation technique should be consistent with generally accepted valuation methodologies for pricing financial instruments (e.g., use of an option pricing model for valuing stock options) and should incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price. Vesting conditions, other than market conditions, should not be taken into account when estimating the fair value of the shares or stock options at the grant date. Instead, vesting conditions should be taken into account by adjusting the number of

shares or stock options included in the measurement of the transaction amount so that, ultimately, the amount recognized for employee services received as consideration for the shares or stock options granted is based on the number of shares or stock options that eventually vest. Hence, on a cumulative basis, no amount is recognized for employee services received if the shares or stock options granted do not vest because of failure to satisfy a vesting condition (i.e., these are forfeited), e.g., the employee fails to complete a specified service period, or a performance condition is not satisfied.

To apply the requirements of the Guidance Note, the enterprise should recognize an amount for the employee services received during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and should revise that estimate, if necessary, if subsequent information indicates that the number of shares or stock options expected to vest differs from previous estimates. On vesting date, the enterprise should revise the estimate to equal the number of shares or stock options that ultimately vest. Market conditions, such as a target share price upon which vesting (or right to exercise) is conditioned, should be taken into account when estimating the fair value of the shares or stock options granted. On exercise of the right to obtain shares or stock options, the enterprise issues shares on receipt of the exercise price. The shares so issued should be considered to have been issued at the consideration comprising the exercise price and the corresponding amount standing to the credit of the relevant equity account (e.g., Stock Options Outstanding Account). In a situation where the right to obtain shares or stock option expires unexercised, the balance standing to the credit of the relevant equity account should be transferred to general reserve.

For cash-settled employee share-based payment plans, the enterprise should measure the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the enterprise is required to re-measure the fair value of the liability at each reporting date and at the date of settlement, with any changes in value recognized in profit or loss for the period.

For employee share-based payment plans in which the terms of the arrangement provide either the enterprise or the employee with a choice of whether the enterprise settles the transaction in cash or by issuing shares, the enterprise is required to account for that transaction, or the components of that transaction, as a cash-settled share-based payment plan if, and to the extent that, the enterprise has incurred a liability to settle in cash (or other assets), or as an equity-settled share-based payment plan if, and to the extent that, no such liability has been incurred.

Accounting for employee share-based payment plans is based on the fair value method. There is another method known as the 'Intrinsic Value Method' for valuation of employee share-based payment plans. Intrinsic value, in the case of a listed company, is the amount by which the quoted market price of the underlying share exceeds the exercise price of an option. In the case of a non-listed company, since the shares are not quoted on a stock exchange, value of its shares is determined on the basis of a valuation report from an independent valuer. For accounting for employee share-based payment plans, the intrinsic value may be used, mutatis

mutandis, in place of the fair value as described in paragraphs 5 to 14.

Apart from the above, the Guidance Note also deals with various other significant aspects of the employee share-based payment plans including those related to performance conditions, modifications to the terms and conditions of the grant of shares or stock options, reload feature, graded vesting, earnings-per-share implications, accounting for employee share-based payments administered through a trust, etc. The Guidance Note also recommends detailed disclosure requirements.

Illustration 1

A Company has its share capital divided into shares of ₹ 10 each. On 1st April, 2012 it granted 10,000 employees' stock options at ₹ 40, when the market price was ₹ 130. The options were to be exercised between 15th March, 2013 and 31st March, 2013. The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year.

Show Journal Entries.

Solution

Journal Entries

	Particulars	*Dr.* ₹	*Cr.* ₹
15th Mar. 2013 to 31st Mar.2013	Bank A/c Dr. Employee compensation expense A/c Dr. To Equity share capital A/c To Securities premium A/c (Being allotment to employees of 9,500 equity shares of ₹ 10 each at a premium of ₹ 120 per share in exercise of stock options by employees)	3,80,000 8,55,000	 95,000 11,40,000
31st March 2013	Profit and Loss A/c Dr. To Employee compensation expense A/c (Being transfer of employee compensation expense to profit and loss account)	8,55,000	 8,55,000

Illustration 2

ABC Ltd. grants 1,000 employees stock options on 1.4.2010 at ₹ 40, when the market price is ₹ 160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.2012. 600 options are exercised on 30.6.2013. 100 vested options lapse at the end of the exercise period.

Pass Journal Entries giving suitable narrations.

Solution

In the books of ABC Ltd.

Journal Entries

Date	*Particulars*		*Dr. (₹)*	*Cr. (₹)*
31.3.2011	Employees compensation expenses account	Dr.	48,000	
	To Employee stock option outstanding account			48,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over 2 $\frac{1}{2}$ years - 1,000 stock options x ₹ 120/2.5 years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at year end)			
31.3.2012	Employees compensation expenses account	Dr.	48,000	
	To Employee stock option outstanding account			48,000
	(Being compensation expense recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortised on straight line basis over 2 $\frac{1}{2}$ years - 1,000 stock options x ₹ 120/2.5 years)			
	Profit and loss account	Dr.	48,000	
	To Employees compensation expenses account			48,000
	(Being expenses transferred to profit and loss account at year end)			
31.3.2013	Employee stock option outstanding account (W.N.1)	Dr.	12,000	
	To General Reserve account (W.N.1)			12,000
	(Being excess of employees compensation expenses transferred to general reserve account)			
30.6.2013	Bank A/c (600 × ₹ 40)	Dr.	24,000	
	Employee stock option outstanding account (600 × ₹ 120)	Dr.	72,000	

	To Equity share capital account (600 × ₹ 10)			6,000
	To Securities premium account (600 x ₹ 150)			90,000
	(Being 600 employee stock option exercised at an exercise price of ₹ 40 each)			
01.10.2013	Employee stock option outstanding account (W.N.2)	Dr.	12,000	
	To General reserve account (W.N.2)			12,000
	(Being ESOS outstanding A/c on lapse of 100 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Notes:

1. At 31.3.2013, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any to reflect expenses for the number of options that actually vested. Considering that 700 stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

No. of options actually vested (700 x 120)	₹ 84,000
Less: Expenses recognized ₹ (48,000 + 48,000)	(₹ 96,000)
Excess expenses transferred to general reserve	₹ 12,000

2. Similarly, on 1.10.2013, Employee Stock Option Outstanding Account will be

No. of options actually vested (600 x 120)	₹ 72,000
Less: Expenses recognized	(₹ 84,000)
Excess expenses transferred to general reserve	₹ 12,000

Employee Stock Options Outstanding will appear in the Balance Sheet as part of Net Worth or Shareholders' Fund.

Illustration 3

Choice Ltd. grants 100 stock options to each of its 1,000 employees on 1.4.2009 for ₹ 20, depending upon the employees at the time of vesting of options. Options would be exercisable within a year it is vested. The market price of the share is ₹ 50 each. These options will vest at the end of year 1 if the earning of Choice Ltd. is 16%, or it will vest at the end of the year 2 if the average earning of two years is 13%, or lastly it will vest at the end of the third year if the average earning of 3 years will be 10%. 5,000 unvested options lapsed on 31.3.2010. 4,000 unvested options lapsed on 31.3.2011 and finally 3,500 unvested options lapsed on 31.3.2012.

Following is the earning of Choice Ltd. :

Year ended on	*Earning (in %)*
31.3.2010	*14%*

31.3.2011	*10%*
31.3.2012	*7%*

850 employees exercised their vested options within a year and remaining options were unexercised at the end of the contractual life. Pass Journal entries for the above.

Solution

Date	Particulars		₹	₹
31.3.2010	Employees compensation expenses A/c	Dr.	14,25,000	
	To ESOS outstanding A/c			14,25,000
	(Being compensation expense recognized in respect of the ESOP i.e. 100 options each granted to 1,000 employees at a discount of ₹ 30 each, amortised on straight line basis over vesting years- Refer W.N.)			
	Profit and Loss A/c	Dr.	14,25,000	
	To Employees compensation expenses A/c			14,25,000
	(Being expenses transferred to profit and Loss A/c)			
31.3.2011	Employees compensation expenses A/c	Dr.	3,95,000	
	To ESOS outstanding A/c			3,95,000
	(Being compensation expense recognized in respect of the ESOP- Refer W.N.)			
	Profit and Loss A/c	Dr.	3,95,000	
	To Employees compensation expenses A/c			3,95,000
	(Being expenses transferred to profit and Loss A/c)			
31.3.2012	Employees compensation Expenses A/c	Dr.	8,05,000	
	To ESOS outstanding A/c			8,05,000
	(Being compensation expense recognized in respect of the ESOP- Refer W.N.)			
	Profit and Loss A/c		8,05,000	
	To Employees compensation expenses A/c			8,05,000
	(Being expenses transferred to profit and Loss A/c)			
2012-13	Bank A/c (85,000 × ₹ 20)	Dr.	17,00,000	
	ESOS outstanding A/c	Dr.	25,50,000	

	[(26,25,000/87,500) x 85,000]			
	To Equity share capital (85,000 x ₹ 10)			8,50,000
	To Securities premium A/c (85,000 x ₹ 40)			34,00,000
	(Being 85,000 options exercised at an exercise price of ₹ 50 each)			
31.3.2013	ESOS outstanding A/c	Dr.	75,000	
	To General Reserve A/c			75,000
	(Being ESOS outstanding A/c on lapse of 2,500 options at the end of exercise of option period transferred to General Reserve A/c)			

Working Note:

Statement showing compensation expenses to be recognized at the end of

Particulars	Year 1 (31.3.2010)	Year 2 (31.3.2011)	Year 3 (31.3.2012)
Number of options expected to vest	95,000 options	91,000 options	87,500 options
Total compensation expense accrued (50-20)	₹ 28,50,000	₹ 27,30,000	₹ 26,25,000
Compensation expense of the year	28,50,000 x 1/2 = ₹ 14,25,000	27,30,000 x 2/3 = ₹ 18,20,000	₹ 26,25,000
Compensation expense recognized previously	Nil	₹ 14,25,000	₹ 18,20,000
Compensation expenses to be recognized for the year	₹ 14,25,000	₹ 3,95,000	₹ 8,05,000

1.2 Buy Back of Securities

The Companies Act, 2013 under Section 68 (1) permits companies to buyback their own shares and other specified securities out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of the issue of any shares or other specified securities.

Note: No buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The other important provisions relating to the buyback are:

(1) Section 68 (2) further states that no company shall purchase its own shares or other specified securities unless—

  (a) the buy-back is authorised by its articles;

  (b) a special resolution has been passed in general meeting of the company authorising the buy-back;

  However, the above provisions do not apply where the buy back is ten percent or less of the paid up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy back is upto 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of its being authorized by the articles of association of the company and by a special resolution of its members passed at a general meeting of the company.

  (c) the buy-back is equal or less than twenty-five per cent of the total paid-up capital and free reserves of the company:

  (d) the ratio of the debt owed by the company (both secured and unsecured) after such buy - back is not more than twice the total of its paid up capital and its free reserves:

  Note: Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.

  (e) all the shares or other specified securities for buy-back are fully paid-up;

  (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

  (g) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

Provided that no offer of buy back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy back if any. This means that there cannot be more than one buy back in one year.

(2) Every buy-back shall be completed within twelve months from the date of passing the special resolution, or the resolution passed by the board of directors where the buy back is upto 10% of the paid up equity capital + free reserves.

(3) The buy-back may be—

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(4) Where a company has passed a special resolution under clause (b) of Sub-section (2) to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any :

Note: No declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(5) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within seven days of the last date of completion of buy-back.

(6) Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

(7) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company may be punishable with a fine which shall not be less than Rs One Lakh but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for upto 3 years or with a fine of not less than one lakh rupees but which may extend to three lakh rupees or with both.

(8) Section 69 (1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.

(9) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(10) Where a company buy-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

(11) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

Some Important Terms

(a) "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time;

(b) "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that-

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

1.2.1 Provisions of Section 70 of the Companies Act 2013

(1) No company shall directly or indirectly purchase its own shares or other specified securities—

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank, is subsisting. Provided that the buy – back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92,123, 127 and 129. Section 92 relates to the filing of Annual Return, Section 123 and 127 to declaration and payment of dividend and Section 129 to the financial statement of the company.

<u>NOTE</u>: In exercise of the powers conferred under section 30 of the Securities and Exchange Board of India Act, 1992, SEBI made Securities and Exchange Board of India (Buy-back of

Securities) (Amendment) Regulations, 2013 to amend the Securities and Exchange Board of India (Buy back of Securities) Regulations, 1998. The important provisions of the new regulations are: (i) No offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market. (ii)A company shall not make any offer of buy-back within a period of one year reckoned from the date of closure of the preceding offer of buy-back, if any. (iii)The company shall ensure that at least fifty per cent of the amount earmarked for buy-back is utilized for buying-back shares or other specified securities.

Illustration 4

Perrotte Ltd. (a non-listed company) has the following Capital Structure as on 31.03.2011:

	Particulars	*(₹ in crores)*	
(1)	*Equity Share Capital (Shares of ₹ 10 each fully paid)*	-	*330*
(2)	*Reserves and Surplus*		
	General Reserve	*240*	-
	Securities Premium Account	*90*	-
	Profit & Loss Account	*90*	-
	Infrastructure Development Reserve	*180*	*600*
(3)	*Loan Funds*		*1,800*

The Shareholders of Perrotte Ltd., on the recommendation of their Board of Directors, have approved on 12.09.2011 a proposal to buy back the maximum permissible number of Equity shares considering the large surplus funds available at the disposal of the company.

The prevailing market value of the company's shares is ₹ 25 per share and in order to induce the existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% over market.

You are also informed that the Infrastructure Development Reserve is created to satisfy Income-tax Act requirements.

You are required to compute the maximum number of shares that can be bought back in the light of the above information and also under a situation where the loan funds of the company were either ₹ 1,200 crores or ₹ 1,500 crores.

Assuming that the entire buy back is completed by 09.12.2011, show the accounting entries in the company's books in each situation.

Solution

Statement determining the maximum number of shares to be bought back

Number of shares

Particulars	*When loan fund is*		
	₹ 1,800 crores	*₹ 1,200 crores*	*₹ 1,500 crores*
Shares Outstanding Test (W.N.1)	8.25	8.25	8.25
Resources Test (W.N.2)	6.25	6.25	6.25
Debt Equity Ratio Test (W.N.3)	Nil	3.75	Nil
Maximum number of shares that can be bought back [least of the above]	Nil	3.75	Nil

Journal Entries for the Buy Back (applicable only when loan fund is ₹ 1,200 crores)

				₹ in crores
			Debit	*Credit*
(a)	Equity share buy back account	Dr.	112.5	
	To Bank account			112.5
	(Being buy back of 3.75 crores equity shares of ₹ 10 each @ ₹ 30 per share)			
(b)	Equity share capital account	Dr.	37.5	
	Securities premium account	Dr.	75	
	To Equity share buy back account			112.5
	(Being cancellation of shares bought back)			
(c)	General reserve account	Dr.	37.5	
	To Capital redemption reserve account			37.5
	(Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)			

Working Notes:

1. **Shares Outstanding Test**

Particulars	*(Shares in crores)*
Number of shares outstanding	33
25% of the shares outstanding	8.25

2. **Resources Test**

Particulars	
Paid up capital (₹ in crores)	330

Free reserves (₹ in crores)	420
Shareholders' funds (₹ in crores)	750
25% of Shareholders fund (₹ in crores)	₹ 187.5 crores
Buy back price per share	₹ 30
Number of shares that can be bought back (shares in crores)	6.25 crores shares

3. Debt Equity Ratio Test

	Particulars	*When loan fund is*		
		₹ 1,800 crores	*₹ 1,200 crores*	*₹ 1,500 crores*
(a)	Loan funds (₹ in crores)	1,800	1,200	1,500
(b)	Minimum equity to be maintained **after** buy back in the ratio of 2:1 (₹ in crores)	900	600	750
(c)	Present equity shareholders fund (₹ in crores)	750	750	750
(d)	Future equity shareholder fund (₹ in crores) **(See Note 2)**	N.A.	712.5 (750-37.5)	N.A.
(e)	Maximum permitted buy back of Equity (₹ in crores) [(d) – (b)] **(See Note 2)**	Nil	112.5 (by simultaneous equation)	Nil
(f)	Maximum number of shares that can be bought back @ ₹ 30 per share (shares in crores) **(See Note 2)**	Nil	3.75 (by simultaneous equation)	Nil

Note:

1. Under Situations 1 & 3 the company does not qualify for buy back of shares as per the provisions of the Companies Act, 2013.
2. As per section 68 of the Companies Act, 2013, the ratio of debt owed by the company should not be more than twice the capital and its free reserve after such buy-back. In the question, it is stated that the company has surplus funds to dispose off therefore, it is presumed that buy- back is out of free reserves or securities premium and hence a sum equal to the nominal value of the share bought back shall be transferred to Capital Redemption Reserve (CRR). Utilization of CRR is restricted to issuance of fully paid-up bonus shares only. It means CRR is not available for distribution as dividend. Hence, CRR is not a free reserve. Therefore, for calculation of future equity i.e. share capital and free reserves, amount transferred to CRR on buyback has to be excluded from present equity.

   Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method.

Suppose amount equivalent to nominal value of bought back shares transferred to CRR account is ‘x’ and maximum permitted buy-back of equity is ‘y’.

Then

Equation 1 :(Present equity – Nominal value of buy-back transfer to CRR) – Minimum equity to be maintained= Maximum permissible buy-back of equity

$(750 - x) - 600 = y$ (1)

Since $150 - x = y$

Equation 2: $\left(\frac{\text{Maximum buy-back}}{\text{Offer price for buy-back}} \text{ x Nominal Value}\right)$

= Nominal value of the shares bought –back to be transferred to CRR

$= \left(\frac{y}{30} \times 10\right) = x$

[here (30 = 25% x 120]

Or $3x = y$ (2)

by solving the above two equations we get

x = ₹ 37.5 crores

y = ₹ 112.5 crores

Illustration 5

Anu Ltd. (a non-listed company) furnishes you with the following summarized balance sheet as at 31st March, 2012:

		(₹ in crores)
Sources of Funds		
Share Capital:		
Authorised		*100*
Issued:		
12% Redeemable preference shares of ₹ 100 each fully paid	*75*	
Equity shares of ₹ 10 each fully paid	*25*	*100*
Reserves and surplus:		
Capital reserve	*15*	
Securities premium	*25*	
Revenue reserves	*260*	*300*
		400

Application of Funds		
Fixed assets: cost	*100*	
Less: Provision for depreciation	*(100)*	*Nil*
Non-current investments at cost (Market value ₹ 400 Cr.)		*100*
Current assets	*340*	
Less: Current liabilities (Trade payables)	*(40)*	*300*
		400

The company redeemed preference shares on 1st April, 2012. It also bought back 50 lakhs equity shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are asked to:

(i) Pass journal entries to record the above.

(ii) Prepare balance sheet as at 1.4.2012.

Solution

Journal entries in the books of Anu Ltd.

₹ in crores

	Particulars		*Debit*	*Credit*
1st April, 2012	12% Preference share capital A/c	Dr.	75	
	To Preference shareholders A/c			75
	(Being preference share capital account transferred to shareholders account)			
	Preference shareholders A/c	Dr.	75	
	To Bank A/c			75
	(Being payment made to shareholders)			
	Shares buy back A/c	Dr.	25	
	To Bank A/c			25
	(Being 50 lakhs equity shares bought back @ ₹ 50 per share)			
	Equity share capital A/c (50 lakhs x ₹ 10)	Dr.	5	
	Securities premium A/c (50 lakhs x ₹ 40)	Dr.	20	
	To Shares buy back A/c			25
	(Being cancellation of shares bought back)			
	Revenue reserve A/c	Dr.	80	
	To Capital Redemption Reserve A/c (75+5)			80
	(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

(ii) **Balance Sheet of Anu Ltd as at 1.4.2012**

Particulars	*Note No*	*₹ in crores*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20
(b) Reserves and Surplus	2	280
(2) Current Liabilities		
(a) Trade payables		40
Total		340
II. Assets		
(1) Non-current assets		
(a) Fixed assets	3	-
(b) Non-current investments -Investment at cost (Market value ₹ 400 crores)		100
(2) Current assets	4	240
Total		340

Notes to Accounts

				₹ in crores
1.	**Share Capital**			
	Authorised, Issued and Subscribed			
	200 lakhs Equity shares of ₹ 10 each			20
2.	**Reserves and Surplus**			
	Capital reserve		15	
	Capital redemption reserve		80	
	Securities premium	25		
	Less: Utilisation for buy back of shares	(20)	5	
	Revenue Reserve	260		
	Less: transfer to Capital redemption reserve	(80)	180	280
3.	**Fixed Assets**			
	Cost		100	
	Less : Provision for depreciation		(100)	-
4.	**Current assets**			
	Current assets as on 31.3.2012		340	
	Less: Bank payment for redemption and buy back		(100)	240

Illustration 6

Extra Ltd. (a non-listed company) furnishes you with the following summarized Balance Sheet as on 31st March, 2012:

(₹ in lakhs)

Liabilities	*Amount*	*Assets*	*Amount*
Equity shares of ₹ 10 each fully paid	*100*	*Fixed assets less depreciation*	*50*
9% Redeemable preference		*Investments at cost*	*120*
shares of ₹ 100 each fully paid	*20*	*Current assets*	*142*
Capital reserves	*8*		
Revenue reserves	*50*		
Securities premium	*60*		
10% Debentures	*4*		
Current liabilities	*70*		
	312		*312*

(i) The company redeemed the preference shares at a premium of 10% on 1st April, 2012.

(ii) It also bought back 3 lakhs equity shares of ₹ 10 each at ₹ 30 per share.

The payment for the above was made out of huge bank balances, which appeared as a part of the current assets.

(iii) Included in its investment were "investments in own debentures" costing ₹ 2 lakhs (face value ₹ 2.20 lakhs). These debentures were cancelled on 1st April, 2012.

(iv) The company had 1,00,000 equity stock options outstanding on the above mentioned date, to the employees at ₹ 20 when the market price was ₹30 (This was included under current liabilities). On 1.04.2012 employees exercised their options for 50,000 shares.

(v) Pass the journal entries to record the above.

(vi) Prepare Balance Sheet as at 01.04.2012.

Solution

(₹ in lakhs)

Date	*Particulars*		*Debit*	*Credit*
01.04.2012	9% Redeemable preference share capital A/c	Dr.	20.00	
	Premium on redemption of preference shares A/c	Dr.	2.00	
	To Preference shareholders A/c			22.00
	(Being preference share capital transferred to shareholders account)			

01.04.2012	Preference shareholders A/c	Dr.	22.00	
	To Bank A/c			22.00
	(Being payment made to shareholders)			
01.04.2012	Equity shares buy back A/c	Dr.	90.00	
	To Bank A/c			90.00
	(Being 3 lakhs equity shares of ₹ 10 each bought back @ ₹30 per share)			
01.04.2012	Equity share capital A/c	Dr.	30.00	
	Securities premium A/c	Dr.	60.00	
	To Equity Shares buy back A/c			90.00
	(Being cancellation of shares bought back)			
01.04.2012	Revenue reserve A/c	Dr.	50.00	
	To Capital redemption reserve A/c			50.00
	(Being creation of capital redemption reserve account to the extent of the face value of preference shares redeemed and equity shares bought back as per the law)			
01.04.2012	10% Debentures A/c	Dr.	2.20	
	To Investment (own debentures) A/c			2.00
	To Profit on cancellation of own debentures A/c			0.20
	(Being cancellation of own debentures costing ₹ 2 lakhs, face value being ₹ 2.20 lakhs and the balance being profit on cancellation of debentures)			
1.04.2012	Profit on cancellation of debentures A/c	Dr.	0.20	
	To Capital reserve A/c			0.20
	(Being profit on cancellation of debentures transferred to capital reserve account)			
01.04.2012	Bank A/c	Dr.	10.00	
	Employees stock option outstanding (Current liabilities) A/c	Dr.	5.00	
	To Equity share capital A/c			5.00
	To Securities premium A/c			10.00
	(Being the allotment to employees, of 50,000 shares of ₹ 10 each at a premium of 20 per share in exercise of stock options by employees)			

01.04.2012	Securities premium A/c	Dr.	2.00	
	To Premium on redemption of preference			2.00
	(Being premium on redemption of preference shares adjusted through securities premium)			

Balance Sheet of Extra Ltd. as on 01.04.2012

Particulars	*Note No*	*(₹ in lakhs)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	75.00
(b) Reserves and Surplus	2	66.20
(2) Non-current Liabilities		
(a) Long term borrowings	3	1.80
(3) Current Liabilities		65.00
Total		208.00
II. Assets		
(1) Non-current assets		
(a) Fixed assets		50.00
(b) Non-current investments at cost		118.00
(2) Current assets		40.00
Total		208.00

Notes to Accounts

			₹ in lakhs
1	**Share Capital**		
	Equity share capital		
	Opening balance	100.00	
	Less : Cancellation of bought back shares	(30.00)	
	Add : Shares issued against ESOP	5.00	75.00
2	**Reserves and Surplus**		
	Capital Reserve		
	Opening balance	8.00	
	Add: Profit on cancellation of debentures	0.20	8.20

	Revenue reserves		
	Opening balance	50.00	
	Less: Creation of Capital Redemption Reserve	(50.00)	-
	Securities Premium		
	Opening balance	60.00	
	Less : Adjustment for cancellation of equity shares	(60.00)	
	Less: Adjustment for premium on redemption of preference shares	(2.00)	
	Add: Shares issued against ESOP at premium	10.00	8.00
	Capital Redemption Reserve		50.00
			66.20
3	**Long term borrowings**		
	Secured		
	10% Debentures (4-2.20)		1.80

Working Notes:

		(₹ in lakhs)
1.	**10% Debentures**	
	Opening balance	4.00
	Less: Cancellation of own debentures	(2.20)
		1.80
2.	**Current liabilities**	
	Opening balance	70.00
	Less: Adjustment for ESOP outstanding	(5.00)
		65.00
3.	**Investments at cost**	
	Opening balance	120.00
	Less: Investment in own debentures	(2.00)
		118.00
4.	**Current assets**	
	Opening balance	142.00
	Less : Payment to preference shareholders	(22.00)
	Less : Payment to equity shareholders	(90.00)
	Add : Share price received against ESOP	10.00
		40.00

Illustration 7

Dee Limited (a non-listed company) furnishes the following summarized Balance Sheet as at 31[st] March, 2012:

	₹ '000	₹ '000
Liabilities		
Share capital:		
Authorised capital		*30,00*
Issued and subscribed capital:		
2,50,000 Equity shares of ₹ 10 each fully paid up	*25,00*	
2,000, 10% Preference shares of ₹ 100 each	*2,00*	
(Issued two months back for the purpose of buy back)		*27,00*
Reserves and surplus:		
Capital reserve	*10,00*	
Revenue reserve	*30,00*	
Securities premium	*22,00*	
Profit and loss account	*35,00*	*97,00*
Current liabilities and provisions		*14,00*
		1,38,00
Assets		
Fixed assets		*93,00*
Investments		*30,00*
Current assets, loans and advances (including cash and bank balance)		*15,00*
		1,38,00

The company passed a resolution to buy back 20% of its equity capital @ ₹ 50 per share. For this purpose, it sold all of its investment for ₹ 22,00,000.

You are required to pass necessary journal entries and prepare the Balance Sheet.

Solution

In the books of Dee Limited

Journal Entries

	Particulars		*Dr.*	*Cr.*
			(₹ in '000)	
(i)	Bank Account	Dr.	22,00	
	Profit and Loss Account	Dr.	8,00	
	To Investment Account			30,00
	(Being the investments sold at loss for the purpose of buy back)			

(ii)	Equity Share capital account	Dr.	5,00	
	Premium payable on buy back Account	Dr.	20,00	
	To Equity shares buy back Account			25,00
	(Being the amount due on buy back)			
(iii)	Securities premium Account	Dr.	20,00	
	To Premium payable on buy back Account			20,00
	(Being the premium payable on buy back adjusted against securities premium account)			
(iv)	Revenue reserve Account	Dr.	3,00	
	To Capital Redemption Reserve Account			3,00
	(Being the amount equal to nominal value of equity shares bought back out of free reserves transferred to capital redemption reserve account)			
(v)	Equity shares buy-back Account	Dr.	25,00	
	To Bank Account			25,00
	(Being the payment made on buy back)			

Balance Sheet of Dee Limited as on 1st April, 2012

(After buy back of shares)

Particulars	*Note No*	*(₹ in 000)*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	22,00
(b) Reserves and Surplus	2	69,00
(2) Current Liabilities		14,00
Total		10,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		93,00
(2) Current assets		12,00
Total		10,500

Notes to Accounts

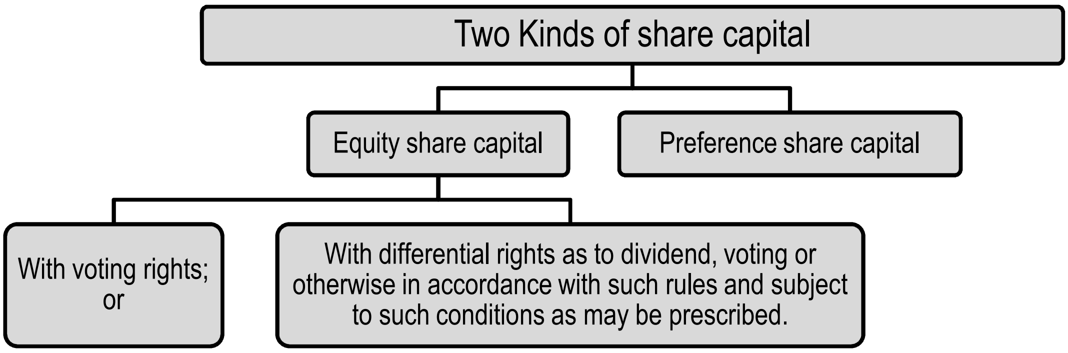
			₹ in 000
1	**Share Capital**		
	Authorised capital:		30,00
	Issued and subscribed capital:		

	2,00,000 Equity shares of ₹ 10 each fully paid up		20,00	
	2,000 10% Preference shares of ₹ 100 each fully paid up		2,00	22,00
2	**Reserves and Surplus**			
	Capital reserve		10,00	
	Capital redemption reserve		3,00	
	Securities Premium	22,00		
	Less: Premium payable on buy back of shares	20,00	2	
	Revenue reserve	30,00		
	Less: Transfer to Capital redemption reserve	3,00	27,00	
	Profit and loss A/c	35,00		
	Less: Loss on investment	8,00	27,00	69,00

1.3 Equity Shares with Differential Rights

The new Companies Amendment Act, 2013 allows companies to issue equity shares with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.

Section 43 of Companies Act : New issues of share capital to be only of two kinds – the share capital of a company limited by shares shall be only two kinds only, as depicted in the chart given below:–



Summary

- ESOP is an option given to whole-time or other directors, officers or employees of a company to purchase or subscribe the securities offered by the company at a future date, at a predetermined price.
- Buy back of shares can be made out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

- No company shall purchase its own shares or other specified securities unless—
- The buy back is authorized by the Articles of Association and by a special resolution passed at a general meeting. However, in case the buy back is for a sum less than or equal to ten percent of the paid up equity shares + free reserves the same may be authorized by the resolution of the directors passed at a duly convened Board Meeting.
- the buy-back is or less than or equal to twenty-five per cent of the total paid-up capital and free reserves of the company:
- Partly paid shares cannot be bought back by a company;
- the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year.
- No offer of buy back will be made within a period of one year from the date of closing of the previous buy back if any. Hence, there can be a maximum of one buy back in one year.
- the ratio of the debt owed by the company (both secured and unsecured) is not more than twice the paid up capital and its free reserves after such buy-back:
- As per the new Companies Act 2013 companies can issue equity shares with differential rights subject to the fulfilment of certain conditions. (Section 43).

Unit – 2 : Underwriting of Shares and Debentures

Learning Objectives

After studying this unit, you will be able to

- Learn the provisions of the Companies Act regarding underwriting of shares
- Determine the liability of underwriters whether shares are fully underwritten or partially underwritten
- Account for firm underwriting of shares.

2.1 Introduction

Underwriting an issue of shares or debentures involves entering into a contract with a person known as underwriter, who may be an individual, partnership or company, undertaking that in the event of the shares or debentures not being subscribed by the public or only a part of them being subscribed, he shall take up the balance. In view of the magnitude of such an obligation, issues of shares or debentures are rarely underwritten by one person. They are either underwritten by two or more persons jointly or only a part of the issue is underwritten and, in respect of rest, the company takes the risk of the capital being not subscribed by the public.

2.2 Underwriting Commission

The function of an underwriter has great economic significance. It provides an assurance to the company that it would be able to raise the stipulated amount of capital by the issue of shares or debentures and, on the basis of such an assurance; company can proceed to draw up its investment programme. The Central Government has recently set up a number of financial institutions for helping companies to raise capital. One of the forms in which such a help is rendered is by underwriting the issues of shares and debentures, made by the companies. The prominent institutions that render this service are: Industrial Finance Corporation, Industrial Credit and Investment Corporation of India and Life Insurance Corporation of India.

In consideration of such a service, the underwriter is paid a commission. The Companies Act, 2013 places certain restrictions on the rate of commission and the conditions under which it can be paid. It provides that commission only at a rate authorized by the Articles, not exceeding 2½% of the issue price of debentures and 5% of issue price of shares, can be paid. No commission can be paid in respect of shares or debentures which have not been offered to the general public for subscription.

2.3 Provisions in the Companies Act affecting Underwriting

Disclosure in the Prospectus - According the Companies Act, it is necessary that when any issue of shares or debentures is underwritten, the names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations should be stated.

Disclosure in the Statutory Report - According to clause (6) of the Form prescribed for such a report, a brief description of each underwritten contract should be given and, if any contract has not been carried out fully, the extent to which it has not been carried out and reasons therefore should be stated. In addition, particulars of any commission paid or payable to any Director, Manager, or their associates should be disclosed.

2.4. Underwriting Contract

There are two types of underwriting contract

(i) Normal Underwriting

(ii) Firm Underwriting

2.4.1 Determination of liability in Respect of a Normal Underwriting Contract

2.4.1.1 Determination of liability where whole of the issue has been underwritten by one person: If the whole of the issue has been underwritten by one person, he is responsible to subscribe for all the shares or debentures that have not been subscribed by the public. In such a case, it is not necessary to know the number of applications which had originated through the underwriter and those which had flowed directly to the company.

2.4.1.2 Determination of liability where only part of the issue has been underwritten: In such a case the company is treated as having underwritten the balance of shares which have not been underwritten. In this assumption, the unmarked applications are treated as marked so far as the company is concerned.

Suppose, a company has issued 10,000 shares of which only 6,000 have been underwritten by X; marked applications exceed 6,000. In such a case, X would not be liable to subscribe for any shares. If, however, there are marked applications for only 5,000 shares X would have to subscribe for 1,000 shares provided on his doing so the total number of shares allotted (including those to X) does not exceed 10,000. If it does, the number of shares which X must subscribe will be reduced to that extent.

2.4.1.3 Determination of liability where the whole or part of the issue has been underwritten by two or more underwriters: In the case in which whole or only part of an issue has been underwritten by a number of underwriters, a difficulty may arise in determining the liability of each of the underwriters; such a difficulty may arise in deciding the basis on which the unmarked applications, *i.e.* the applications which have directly flowed to the company should be allocated among the different underwriters. Marked applications are those

applications which are received through an underwriter and such applications are to his credit against his overall obligations.

The allocation of unmarked applications to the underwriters can be done in any one of the two ways: according to one method, the unmarked applications are allotted in the proportion of gross amount of capital underwritten; alternatively these are allocated in proportion to the gross amount of capital underwritten as reduced by the marked applications. How the liability of underwriters is determined by following one or the other method, is explained below :

Elahi Buksh & Co. Ltd. issued 10,000 equity shares. These were underwritten as follows:

A	40%	B	35%	C	25%

In all, applications for 8,000 shares were received; applications for 2,000 shares have the stamp of A; those for 1,000 shares that of B, and those for 2,000 shares that of C. There were thus applications for 3,000 shares which did not bear any stamp or which were unmarked. If credit for unmarked applications is given to A, B and C in proportion to their gross liability, the liability of each of the underwriters will be as shown below:

	A	B	C
Gross liability as underwritten	4,000	3,500	2,500
Less: Unmarked applications			
3,000 shares in the ratio of 40:35:25	(1,200)	(1,050)	(750)
Gross Liability of underwriters	2,800	2,450	1,750
Marked applications	2,000	1,000	2,000
Balance	800	1,450	(250)
Credit to A and B for C's surplus (ratio 40:35)	(133)	(117)	250
Actual liability	667	1,333	—

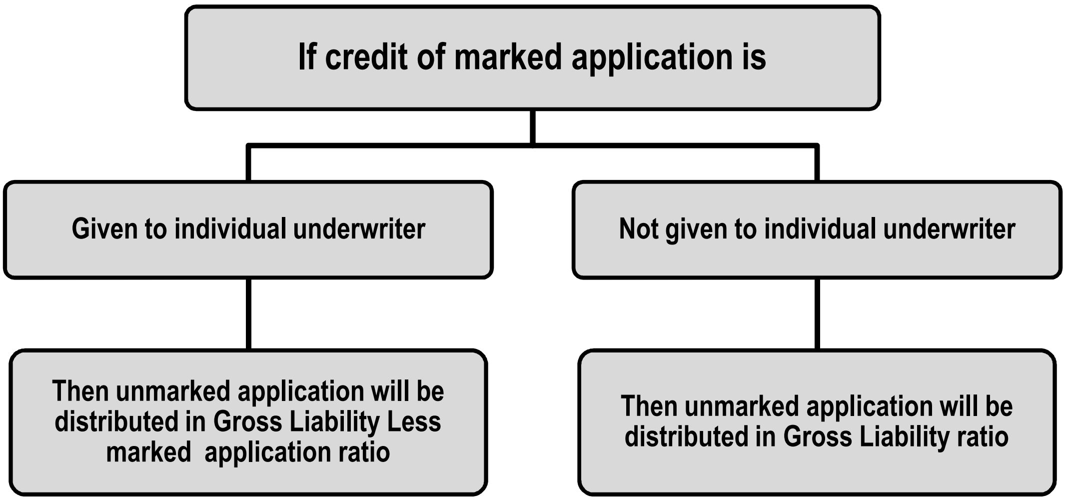
If however, the other view is taken that unmarked applications should be credited to different underwriters in the ratio of liability after credit for marked applications has been given - the position will be as follows :

	A	B	C
Gross liability	4,000	3,500	2,500
Less: marked applications	(2,000)	(1,000)	(2,000)
Liability net of marked applications	2,000	2,500	500
Less: Unmarked applications	(1,200)	(1,500)	(300)
(Shares in ratio of 20:25:5)			
Net liability	800	1,000	200

The liability in this case could also be determined by simply apportioning the total number of shares yet to be subscribed (2,000 in the above case) in the proportion of the balance of the liability after credit for marked forms has been given. Since the liability of each underwriter

may vary widely if one or the other method is followed, the underwriting contract should specify the method to be followed.

Note: Students are advised to clarify the position by way of suitable note in the examination.



In case the information as regards the number of applications that are marked and those that are unmarked is not available in the given question, it should be assumed that out of the total number of applications received, a number proportionate to the value of the issue underwritten has been received through the underwriters.

The surplus shown by the particular underwriters is to be credited to the other underwriters in same proportion as for unmarked applications.

Illustration 1

Newton Limited incorporated on 1st January, 2013 issued a prospectus inviting applications for 20,000 equity shares of ₹ 10 each. The whole issue was fully underwritten by Adams, Benzamin and Clayton as follows:

Adams	*10,000 shares*
Benzamin	*6,000 shares*
Clayton	*4,000 shares*

Applications were received for 16,000 shares, of which marked applications were as follows:

Adams	*8,000 shares*
Benzamin	*2,850 shares*
Clayton	*4,150 shares*

You are required to find out the liabilities of individual underwriters.

Solution

Statement of Net Liability of Underwriters

	Gross liability	Marked appli-cations	Number of Unmarked applications in the ratio of gross liability	Shares Total (2) + (3)	Surplus of Clayton in the ratio of 10:6	Total (4)+(5)	Net liability (1)- 6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Adams	10,000	8,000	500	8,500	219	8,719	1,281
Benzamin	6,000	2,850	300	3,150	131	3,281	2,719
Clayton	4,000	4,150	200	4,350	-350	4,000	–
	20,000	15,000	1,000	16,000	–	16,000	4,000

Note: The applications are for 16,000 shares out of which 15,000 are marked. Hence unmarked applications are for 1,000 shares.

2.4.2 Firm Underwriting

It signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him that is to say, the underwriter is obliged to take up :

(*i*) The number of shares he has applied for 'firm'; and

(*ii*) The number of shares he is obliged to take up on the basis of the underwriting agreement.

In other words, in such cases the obligation or liability of the underwriter is the aggregate of shares to be taken up under firm commitment and the shares as per underwriting commitment.

Let us say, A underwrites 60% of an issue of 10,000 shares and besides applies for 1,000 shares, 'firm'. In case there are marked applications for 4,800 shares he will have to take 2,200 shares, *i.e.* 1,000 shares for which he applied 'firm' and 1,200 shares to meet his liability of underwriting contract. If, on the other hand, the underwriting contract has provided that abatement would be allowed in respect of shares taken up 'firm' the liability of A in the above-mentioned case would only be for 1,200 shares in total.

2.4.2.1 When the Issue is Fully Underwritten [with Firm Underwriting]

There are two alternative ways:

(i) The benefit of firm underwriting is not given to individual underwriter, or

(ii) The benefit of firm underwriting is given to individual underwriter.

(i) The benefit of firm underwriting is not given to individual Underwriter:

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide the resultant in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******
Add: Applications under firm underwriting	******
Total unmarked applications	******

Divide the above calculated unmarked applications in the ratio of **gross liability.**

If the resultant figures of Step 3 are all positive or zero, then it represents **net liability** as per agreement. After this step, go to Step 5 (skip Step 4).

If some of the resultant figures are negative, then continue to Step 4.

Step 4 Add all the negative figures and divide the resultant between the underwriters having positive figures in the ratio of **gross liability.** Repeat Step 4 unless all figures are non-negative. Now these figures represent the **net liability** as per agreement. After this step, to Step 5.

Step 5 Add firm underwriting with the **net liability** as per agreement. The resultant figures represent **total liability.**

Here,

(1) Firm underwriting is treated as unmarked applications and divided in the ratio of gross liability.

(2) The liability of underwriter consists of:

(a) Net liability as per agreement; and

(b) Firm underwriting.

(ii) The benefit of firm underwriting is given to individual underwriter

For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability in the usual manner (if it has not been given).

Step 2 Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide their sum in the ratio of gross liability.

Step 3 Determine the number of unmarked applications as follows:

Total subscriptions (excluding firm underwriting)	******
Less: Marked applications (excluding firm underwriting)	******
Unmarked applications by public	******

Divide the above calculated unmarked application in the **ratio of gross liability.**

Step 4 Subtract "firm underwriting" of individual underwriter from the respective figures of Step 3.

If the resultant figures of Step 4 are all positive or zero, then that represents net liability as per agreement. After this step, go to Step 6 (skip Step 5).

If some of the resultant figures are negative, then continue to Step 5.

Step 5 Add all negative figures and divide it between the underwriters having positive figures in the ratio of gross liability. Repeat Step 5 unless all figures are non-negative. Now these figures represent the net liability as per agreement. After this step, go to Step 6.

Step 6 Add firm underwriting with the net liability as per agreement. The resultant figures represent total liability.

Here,

(1) Firm underwriting is not treated as unmarked applications.

(2) Firm underwriting is credited to individual underwriters separately.

(3) The liability of Underwriter consists of:

(a) Net liability as per agreement; and

(b) Firm underwriting.

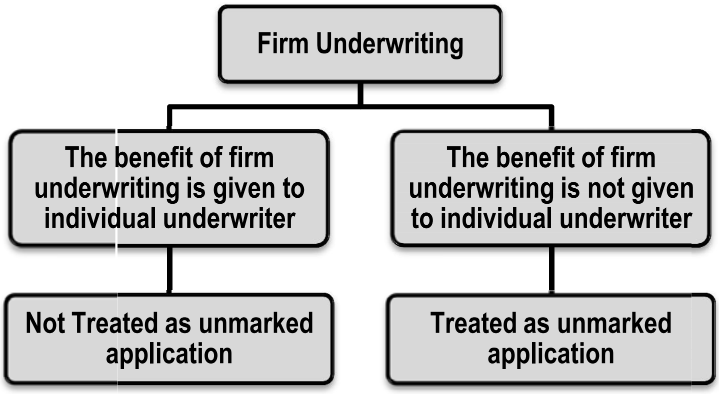


Illustration 2

Rosy Ltd. made a public issue of 4,00,000 equity shares of ₹ 10 each, ₹ 2 payable on application. The entire issue was underwritten by five underwriters as follows: A: 25%, B: 25%, C: 25%, D: 10% and E: 15%. Under the underwriting terms, a commission of 2% was payable on the amount underwritten. Further, the underwriter was at liberty to apply, during the tenure of public issue, for any number of shares in which case he was entitled to a brokerage equal to 1/2% of the par value of shares so applied for.

Applications received were to be analyzed on the basis of rubber stamp of the underwriter, who was to be given credit for the number of applications received bearing his rubber stamp. Applications received which did not bear any rubber stamp were considered as "direct applications" to be credited to all the underwriters in the ratio of their respective underwriting commitment. If, any such credit being given a "surplus" was to result in respect of any underwriter, as compared to his commitment, such surplus was to be distributed amongst the remaining underwriters in the ratio of their respective underwriting commitments.

As a result of the issue the following applications were received:

Bearing rubber stamp of	*A*	*1,02,000 shares*
-Do-	*B*	*95,000 shares*
-Do-	*C*	*60,000 shares*
-Do-	*D*	*32,000 shares*
-Do-	*E*	*51,000 shares*
Not bearing any stamp		*10,000 shares*
		3,50,000 shares

Included in the number of applications mentioned against D in the above table was an application made by D himself for 10,000 shares. The underwriters were informed of the amounts due to or from them, the amounts were duly received or paid.

Show, with the aid of necessary workings, the entries to record the amount so received or paid.

Solution

Journal Entry

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	57,500	
Underwriting commission A/c	Dr.	80,000	
Brokerage on shares A/c	Dr.	500	
To Equity Shares applications A/c			1,00,000
To Bank A/c			38,000

Working Notes: (for description of the columns see below)

Name	1	2	3	4	5	6	7	8	9	10	11	12
A.	1,00,000	1,02,000	2,500	1,04,500	–4,500	1,00,000	—	—	20,000	—	—	20,000
B.	1,00,000	95,000	2,500	97,500	1,500	99,000	1,000	2,000	20,000	—	—	18,000
C.	1,00,000	60,000	2,500	62,500	1,500	64,000	36,000	72,000	20,000	—	52,000	—
D.	40,000	32,000	1,000	33,000	600	33,600	6,400	12,800	8,000	500	4,300	—
E.	60,000	51,000	1,500	52,500	900	53,400	6,600	13,200	12,000	—	1,200	—
	4,00,000	3,40,000	10,000	3,50,000	—	3,50,000	50,000	1,00,000	80,000	500	57,500	38,000

Column No.

(1) Commitment—No. of Shares

(2) Marked Applications

(3) Additional proportionate no. of direct applications or unmarked applicaitons

(4) Total (2) + (3)

(5) Allocation of surplus – done in the ratio of underwriting i.e 25:25:10:15 (B, C, D & E)

(6) Total (4)+(5) – this will be the total credited applications

(7) Final Deficit (1)—(6): Commitment – Total Credited Applicaitons

(8) Amount Receivable from underwriters due @ ₹ 2 per share.

(9) Underwriting Commission due @ 2 % nominal value.

(10) Brokerage due @ 1/2%: Only payable to D for 10,000/- shares applied by him on par value of the shares i.e on Rs 100,000

(11) Due from underwriters.

(12) Due to underwriters.

Illustration 3

Libra Ltd. came up with an issue of 20,00,000 equity shares of ₹ 10 each at par. 5,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters Anand, Vijay and Ashok - equally with firm underwriting of 50,000 shares each. Subscriptions totalled 12,97,000 shares including the marked forms which were :

Anand	*4,25,000 shares*
Vijay	*4,50,000 shares*
Ashok	*3,50,000 shares*

The underwriters had applied for the number of shares covered by firm underwriting. The amounts payable on application and allotment were ₹ 2.50 and ₹ 2.00 respectively. The agreed commission was 5%.

Pass summary journal entries for —

(a) The allotment of shares to the underwriters;

(b) The commission due to each of them; and

(c) The net cash paid and or received.

Note: *Unmarked applications are to be credited to underwriters equally. Benefit of firm underwriting is given to individual underwriter.*

Solution

Libra Ltd.
Journal

		Dr. ₹	Cr. ₹
Bank A/c	Dr.	3,75,000	
To Share Application A/c			3,75,000
(Application money received on firm applications for 50,000 each @ ₹ 2.50 per share from Anand, Vijay & Ashok)			
Anand	Dr.	1,00,000	
Vijay	Dr.	1,00,000	
Ashok	Dr.	3,38,500	
Share Application A/c	Dr.	3,75,000	
To Share Capital A/c			9,13,500
(Allotment of shares to underwriters 50,000 to Anand; 50,000 to Vijay and 1,03,000 to Ashok; application and allotment money credited to share capital)			
Underwriting Commission A/c	Dr.	7,50,000	
To Anand			2,50,000
To Vijay			2,50,000

To Ashok (Amount of underwriting commission payable to Anand, Vijay and Ashok @ 5% on the amount of shares underwritten.)			2,50,000
Bank A/c	Dr.	88,500	
To Ashok (Amount received from Ashok on shares allotted less underwriting commission)			88,500
Anand	Dr.	1,50,000	
Vijay	Dr.	1,50,000	
To Bank A/c (Amount paid to Anand & Vijay in final settlement of underwriting commission due less amount payable on shares allotted payable to him.)			3,00,000

Working Notes :

(1) Calculation of Liability of Underwriters

	Anand	Vijay	Ashok
Gross Liability (No. of shares)	5,00,000	5,00,000	5,00,000
Less : Marked Applications(excluding firm underwriting)	(4,25,000)	(4,50,000)	(3,50,000)
	75,000	50,000	1,50,000
Less : Unmarked Applications (equally)	(24,000)	(24,000)	(24,000)
	51,000	26,000	1,26,000
Less : Firm Underwriting	(50,000)	(50,000)	(50,000)
	1,000	(24,000)	76,000
Surplus of Vijay distributed between Anand & Ashok equally	(12,000)	24,000	(12,000)
	(11,000)	-	64,000-
Surplus of Anand allocated to Ashok totally	11,000	—	(11,000)
	11,000	—	64,000
Less : Adjustment of Anand's surplus	(11,000)	—	(11,000)
Net liability, excluding firm underwriting	—	—	53,000
Add: Firm underwriting	50,000	50,000	50,000
Total liability of underwriters	50,000	50,000	1,03,000

(2) Calculation of Amounts Payable by Underwriters

	Anand	Vijay	Ashok
Liability (No. of shares)	50,000	50,000	1,03,000
Amount payable @ ₹ 4.50 per share	2,25,000	2,25,000	4,63,500
Less : Amount paid on Firm Applications of 50,000 each @ ₹ 2.50	(1,25,000)	(1,25,000)	(1,25,000)

Balance payable	1,00,000	1,00,000	3,38,500
Underwriting Commission Receivable	2,50,000	2,50,000	2,50,000
Amount Paid	1,50,000	1,50,000	—
Amount received by the Co.	—	—	88,500

Illustration 4

A company made a public issue of 1,25,000 equity shares of ₹ 100 each, ₹ 50 payable on application. The entire issue was underwritten by four parties: A, B, C, and D in the proportion of 30% and 25%, 25% and 20% respectively. Under the terms agreed upon, a commission of 2% was payable on the amounts underwritten.

A, B, C, and D also agreed on 'firm'; underwriting of 4,000, 6,000, Nil and 15,000 shares respectively.

The total subscriptions, excluding firm underwriting, including marked applications were for 90,000 shares. Marked applications received were as under :

A 24,000 C 12,000 B 20,000 D 24,000

Ascertain the liability of the individual underwriters and also show the journal entries that you would make in the books of the company. All workings should form part of your answer.

Solution:

When the benefit of firm underwriting is given to individual underwriters.

(i) Total marked applications:

A	B	C	D	
24,000	+20,000	+12,000	+24,000	= 80,000

(ii) Shares subscribed excluding firm underwriting

Total applications	90,000	shares
Less : Marked applications	(80,000)	shares
Unmarked	10,000	

(iii) Statement showing Liability of underwriters

	A	*B*	*C*	*D*	*Total*
Gross liability (30:25:25:20)	37,500	31,250	31,250	25,000	1,25,000
Less : Marked applications	(24,000)	(20,000)	(12,000)	(24,000)	(80,000)
	13,500	11,250	19,250	1,000	45,000
Less : Unmarked (in Gross Ratio)	(3,000)	(2,500)	(2,500)	(2,000)	(10,000)
	10,500	8,750	16,750	–1,000	35,000
Less : Firm underwriting	(4,000)	(6,000)	–	(15,000)	(25,000)
	6,500	2,750	16,750	–16,000	10,000

Less : Surplus of 'D'allotted to A, B & C (30:25:25)	(6,000)	(5,000)	(5,000)	–	–
	500	(2,250)	11,750	–	10,000
Surplus of 'B' allotted	500	–	1,750	–	–
Net liability	–	–	10,000	–	10,000

(iv) Statement of underwriters' liability

Firm	4,000	6,000	–	15,000	25,000
Others	–	–	10,000	–	10,000
	4,000	6,000	10,000	15,000	35,000

(v) Amounts due from underwriters

	A	B	C	D	Total
Shares to be subscribed as per (iv) above	4,000	6,000	10,000	15,000	35,000
Amount due @ ₹ 50 per share	2,00,000	3,00,000	5,00,000	7,50,000	17,50,000
Less : Commission due of shares underwritten	(75,000)	(62,500)	(62,500)	(50,000)	(2,50,000)
	1,25,000	2,37,500	4,37,500	7,00,000	15,00,000

When the benefit of firm underwriting is not given to individual underwriter:

(i) Total marked applications = 24,000+20,000+12,000+24,000 = 80,000

(ii) Shares subscribed excluding 'Firm' underwriting but including

Marked applications	90,000	shares
Add: 'Firm' underwriting	25,000	shares
Total subscription	1,15,000	shares
Less: Marked Applications	(80,000)	shares
Balance being unmarked	35,000	shares

(vi) Check:

(a) Taken by public - unmarked applications	10,000	shares
(b) Public through underwriters - marked	80,000	shares
(c) By underwriters - under agreement	35,000	shares
	1,25,000	shares

Journal Entry

		₹	₹
Bank A/c	Dr	60,00,000	
Underwriting Commission A/c	Dr	2,50,000	
Equity share Application A/c			62,50,000

Illustration 5

Outset Ltd. invited applications from public for 1,00,000 equity shares of ₹ 10 each at a premium of ₹ 5 per share. The entire issue was underwritten by the underwriters P, Q, R and S to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3,000, 2,000, 1,000 and 1,000 shares respectively. The underwriters were entitled to the maximum commission permitted by law.

The company received applications for 70,000 shares (excluding firm underwriting) from public out of which applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of P, Q, R and S respectively.

Calculate the liability of each underwriter. Also ascertain the underwriting commission payable to different underwriters.

Solution

Calculation of liability of each underwriter assuming that the benefit of firm underwriting is not given to individual underwriters

					(Number of shares)
	P	Q	R	S	Total
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked applications (excluding firm underwriting)	(19,000)	(10,000)	(21,000)	(8,000)	(58,000)
Balance	11,000	20,000	(1,000)	12,000	42,000
Less: Surplus of R allocated to P, Q and S in the ratio of 3:3:2	(375)	(375)	1,000	(250)	-
Balance	10,625	19,625	-	11,750	42,000
Less: Unmarked applications including firm underwriting	(5,700)	(5,700)	(3,800)	(3,800)	(19,000)
Net Liability	4,925	13,925	(3,800)	7,950	23,000
Less: Surplus of R allocated to P, Q and S in the ratio of 3:3:2	(1,425)	(1,425)	3,800	(950)	-
	3,500	12,500	-	7,000	23,000
Add: Firm underwriting	3,000	2,000	1,000	1,000	7,000
Total Liability	6,500	14,500	1,000	8,000	30,000

Calculation of underwriting commission:

As per law in force, underwriting commission is payable @ 5% of the issue price of shares.

Underwriting commission payable to P and Q = 5% of (₹ 15 × 30,000 shares) = ₹ 22,500.

Underwriting commission payable to R and S = 5% of (₹ 15 x 20,000 shares)= ₹ 15,000.

Working Note:

Application received from public	70,000 shares
Add: Shares underwritten firm	7,000 shares
Total application	77,000 shares
Less: Marked applications	(58,000 shares)
Unmarked application including firm underwriting	19,000 shares

Unit – 3 : Redemption of Debentures

Learning Objectives

After studying this unit, you will be able to

- ♦ Apply sinking fund method for the redemption of debentures.
- ♦ Deal with purchase of own debentures in the open market
- ♦ Account for interest on own debentures
- ♦ Solve problems based on conversion of debentures

3.1 Introduction

A debenture is a bond issued by a company under its seal, acknowledging a debt and containing provisions as regards repayment of the principal and interest.

Under section 71 (1) of the Companies Act 2013, a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a duly convened general meeting. Section 71 (2) further provides that no company can issue any debentures which carry any voting rights.

Section 71 (4) provides that where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilized by the company for any purpose other than the redemption of debentures.

Basic provisions

If a charge has been created on any or the entire asset of the company,

- ➢ the nature of the charge
- ➢ the assets charged

are described therein.

- Since the charge is not valid unless registered with the Registrar, his certificate registering the charge is printed on the bond.
- It is also customary to create a trusteeship in favor of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever way they think necessary to safeguard the interest of debenture holders.

Issue of debentures has been discussed in detail at Common Proficiency Test level. Students are advised to refer the CPT study material chapter 9 for their understanding.

3.2 Redemption of Debentures

Debentures are usually redeemable, but a company may also issue irredeemable debentures.

Redeemable debentures may be **redeemed**

- after a **fixed number** of years or
- any time after a **certain number of years** has elapsed since their issue,
- on giving a **specified notice**, or by **annual drawing**

A company may also purchase its debentures, as and when convenient in the open market and when debentures are quoted at a discount on the Stock Exchange, it may be profitable for the company to purchase and cancel them or, when it is desired, to keep the debentures alive with a view of issuing them again at a later date.

3.3 Debenture Redemption Reserve

A company issuing debentures is required to create a debenture redemption reserve account out of the profits available for distribution of dividend and amounts credited to such account cannot be utilized by the company except for redemption of debentures. Such an arrangement would ensure that the company will have sufficient liquid funds for the redemption of debentures at the time they shall fall due for payment.

Adequacy of Debenture Redemption Reserve (DRR)

Ministry of Corporate Affairs has made the following clarification on adequacy of Debenture Redemption Reserve (DRR) vide Circular no. 04/2013 dated 11 February, 2013:-

		Adequacy of Debenture Redemption Reserve (DRR)
(i)	For debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures.	No DRR is required
(ii)	For other Financial Institutions (FIs) within the meaning given in the Companies Act.	DRR will be as applicable to NBFCs registered with RBI.
(iii)	For debentures issued by NBFCs registered with the RBI.	25% of the value of debentures issued through public issue. No DRR is required in the case of privately placed debentures.
(iv)	For debentures issued by other companies including manufacturing and infrastructure companies.	25% of the value of debentures issued through public issue. Also 25% DRR is required in the case of

		privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of debentures.

3.3.1 Liability of the Company to Create Debenture Redemption Reserve

Section 71 (4) in the Companies Act 2013 covers the requirement of creating the Debenture Redemption Reserve. The Section 71 states as follows:

(1) Where a company issues debentures under this section, it shall create a debenture redemption reserve account out of its profits which are available for distribution of dividend every year until such debentures are redeemed.

(2) The amounts credited to the debenture redemption reserve shall not be utitlised by the company except for the purpose aforesaid.

(3) The company referred to in sub-section (1) shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(4) Where a company fails to redeem the debentures on the date of maturity or fails to pay the interest on debentures when they fall due, the Tribunal may, on the application of any or all the holders of debentures or debenture trustee shall, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith by the payment of principal and interest due thereon

3.3.2 Balance in Debenture Redemption Reserve (DRR)

The balance to the credit of Debenture Redemption Fund, may in certain circumstances may either be more or less as compared to the amount of debentures which are proposed to be redeemed.

- If it is in excess, the amount is transferred to the Capital Reserve, on the assumption that it is a capital profit received on the appreciation in the value of investments or settlement of liability for a lesser amount that what was usually payable.
- On the other hand, if it is short, the deficit is made up by the transfer from Profit and Loss Account. The balance in the account, equal to the amount of debentures redeemed is subsequently transferred to General Reserve.

Debentures sometimes are redeemable at a premium. In such a case, the appropriation to the Redemption Reserve Fund should be sufficient to pay both the amount of debentures and the premium on redemption. When the company decides to establish the Debenture Redemption Reserve Account at the end of the first year, the amount indicated by the Debenture Redemption Reserves tables is credited to the Debenture Redemption Reserve account and debited to profit and loss account. That shows the intention of the company to set aside regular sums of money to build up a fund for redeeming debentures. Immediately, the company should also purchase outside investments. The entry for the purpose naturally will be

to debit Debenture Redemption Reserve investments and credit bank. It is sometimes thought that since Government securities or individual debentures are available in multiples of ₹ 100 the investments should be made to the nearest of ₹ 100. This may be true in the case of a new issue otherwise, if securities are purchased from the market, it is possible generally to invest any sum of money that may be desired.

In the subsequent years, when interest is received on investments, the bank account will be debited and interest on Debenture Redemption Reserve investments account will be credited. The balance in the latter account will be transferred to the Debenture Redemption Reserve account; the annual instalment will be debited to the profit and loss appropriation account and credited to the Debenture Redemption Reserve account. The investments every year will be of an amount equal to the annual instalment plus the interest which may have been received in the year concerned. Thus, the Debenture Redemption Reserve will go on accumulating each year. [Note : Infact, a notional entry of transfer of interest (and also profit or loss on realisation of Debenture Redemption Reserve investments) to the profit and loss account and then again to Debenture Redemption Reserve will meet strict requirement of law and AS 13 as well.]

Note: It may be stated that the Debenture Redemption Reserve is to be sometimes *non-cumulative*. In that case, interest received on Debenture Redemption Reserve investments will not be credited to Debenture Redemption Reserve nor it will be invested; the amount of the interest will be credited to the profit and loss account.

In the last year, the Debenture Redemption Reserve investments will be realised; the amount will be debited to the bank account and credited to the Debenture Redemption Reserve investments account. If there is any loss or profit, it will be transferred to the Debenture Redemption Reserve account, with the corresponding entry in the Debenture Redemption Reserve investment account. Thus, the amount available by sale of investments will be utilised to pay off the debentures; debentures account will be debited and the bank account credited. The Debenture Redemption Reserve account will still show a big credit balance almost equal to the amount of the debentures. This will be transferred to the general reserve.

Note: Investments may be realised from time to time and debentures may be purchased either for immediate cancellation or as investment as the company pleases. In that case, also the profit or loss on the sale of investments should be transferred to the Debenture Redemption Reserve investment; the interest saved on such debentures should be debited to the debenture interest account and credited to the interest on Debenture Redemption Reserve account directly.

From the accounting point of view, the purchase of debentures involves two problems first, adjustment of the premium or discount, if any paid on their purchase and second, adjustment of interest payable on them. Where a Debenture Redemption Reserve is kept the amount of premium or discount is adjusted therein on cancellation so that at the date of redemption, the balance of the Debenture Investments Account, is equal to the Debenture Account. But, if there is none, Debenture Investments are treated like other investments.

As regards interest, where there is a Debenture Redemption Reserve, the interest on debentures held as an investment made out of the fund is credited to the Debenture Redemption Reserve in exactly the same way as the debentures are outside investments. But where there is no Debenture Redemption Reserve, since the adjustment of interest on debentures held as investments would merely involve crediting and debiting the Profit and Loss Account by the same amount, often it is not made. However, on their purchase or cancellation an amount equal to the nominal value of debentures is transferred to General Reserve from the Profit & Loss Account on the consideration that to such an extent the profits will not be available for distribution.

If the debentures are purchased within the interest period, the price would be inclusive of interest provided these are purchased "cum interest"; but if purchased "ex Interest" the interest to the date of purchase would be payable to the seller in addition. In order to adjust the effect thereof the amount of interest accrued till the date of purchase, if paid, is debited to the Interest Account against which the interest for the whole period will be credited. Thus, in result, a balance in the Account would be left, equal to the interest for the period the debentures were held by the company.

3.3.3 Investment of Debenture Redemption Reserve (DRR) Amount

Every company required to create/maintain DRR shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than fifteen percent of the amount of its debentures maturing during the year ending on the 31st day of March next following in any one or more of the following methods, namely:

(a) in deposits with any scheduled bank, free from charge or lien;

(b) in unencumbered securities of the Central Government or of any State Government;

(c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

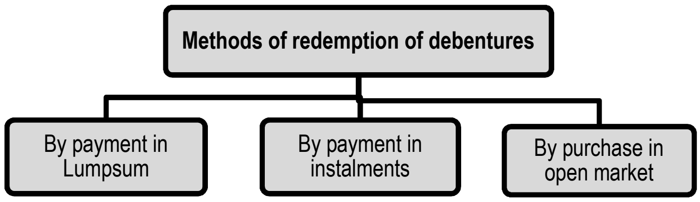
(d) in unencumbered bonds issued by any other company which is notified under clause (f) of section 20 of the Indian Trusts Act, 1882;

The amount deposited or invested, as the case may be, above shall not be utilized for any purpose other than for the repayment of debentures maturing during the year referred to above, provided that the amount remaining deposited or invested, as the case may be, shall not at any time fall below 15 per cent of the amount of debentures maturing during the 31st day of March of that year.

3.4 Methods of Redemption of Debentures

Redemption of debentures must be done according to the terms of issue of debentures and any deviation therefrom will be treated as a default by the company.

Redemption by paying off the debt on account of debentures issued can be done in one of the three methods viz:



3.4.1 By payment in lumpsum

Under payment in lumpsum method, at maturity or at the expiry of a specified period of debenture the payment of entire debenture is made in one lot or even before the expiry of the specified period after passing the necessary resolution at the meeting of debenture holders.

3.4.2 By payment in Instalments

Under payment in installments method, the payment of specified portion of debenture is made in installments as specified intervals.

3.4.3 Purchase of Debentures in Open Market

Debentures sometimes are purchased in open market, where there is a Debenture Redemption Reserve out of the reserve and, if there is none, as a general investment; the Debenture Investment Account or Own Debenture Account is debited.

Suppose a company has issued 8% debentures for ₹ 10,00,000, interest being payable on 31st March and 30th September. The company purchases ₹ 50,000 debentures at ₹ 96 on 1st August 2012. This means that the company will have to pay ₹ 48,000 as principal plus ₹ 1,333 as interest for 4 months.

Entry		₹	₹
Own Debentures	Dr.	48,000	
Interest Account	Dr.	1,333	
To Bank			49,333

It should be noted that even though ₹ 50,000 debentures have been purchased for ₹ 48,000 there is no profit. On purchase of anything, profit does not arise; only on sale, and in this case on cancellation of debentures, will the question of profit or loss could arise.

On 30th September, the company will have to pay ₹ 38,000 as interest to outsiders, *i.e.* 8% on ₹ 9,50,000 for six months. But since the company is keeping the debentures alive, it means, it has saved interest for two months. Therefore, ₹ 667 should be debited to Debentures Interest Account and credited to the Profit and Loss Account. If this entry is passed, it will be noted that the debenture interest account will be debited by the full amount of ₹ 40,000 which is interest for six months on ₹ 10 lakhs. This should be so since in the balance sheet it will be a liability of ₹ 10,00,000. ₹ 50,000 own debentures will be shown on the assets side of the Balance Sheet. However, in the amount column only ₹ 48,000 will be entered.

Suppose out of those debentures ₹ 30,000 is sold at ₹ 98 cum interest on 1st March, 2013 and the remaining ₹ 20,000 is cancelled on 31st March, 2013. The journal entries to be passed will be the following:

		₹	₹
1st March, 2013			
(1) Bank	Dr.	29,400	
To Own Debentures A/c			28,400
To Interest A/c			1,000
(Sale of ₹ 30,000 Debenture @ ₹ 98 cum interest for 5 months credited to Interest A/c the balance being the sale price proper)			
(2) Profit and Loss A/c	Dr.	400	
To Own Debentures A/c			400
(The loss on ₹ 30,000 Own Debentures whose purchase price was ₹ 28,800 at 96)			
31st March, 2013			
8% Debentures A/c	Dr.	20,000	
To Own Debentures A/c			19,200
To Capital Reserve A/c			800
(Cancellation of ₹ 20,000 Debentures)			

It should be noted that the profit on cancellation or redemption of debentures should be treated as a capital profit and, therefore, credited to the capital reserve.

Illustration 1

On January 1, Rama Ltd., had outstanding in its books 500 Debentures of ₹ 100 each interest at 6% per annum. In accordance with the powers in the deed, the directors acquired in the open market Debentures for immediate cancellation as follows :

March 1	*₹ 5,000 at ₹ 98.00 (cum interest)*
Aug. 1	*₹ 10,000 at ₹ 100.25 (cum interest)*
Dec. 15	*₹ 2,500 at ₹ 98.50 (ex-interest)*

Debenture interest is payable half-yearly, on 30th June and 31st Dec.

Show ledger accounts of Debentures, Debenture interest and profit or loss on cancellation, ignoring income-tax.

Solution

6% Debentures Account

1st Half Year

		₹	₹			₹
Mar. 1	To Bank-Debentures Purchased	4,850		Jan. 1	By Balance b/d	50,000
	To Profit & Loss on cancellation of debenture A/c	150	5,000			
June 30	To Balance c/d		45,000			
			50,000			50,000

Profit & Loss on Cancellation of Debentures

June 30	To Capital Reserve (transfer)	₹150	Mar. 1	By Debenture Account	₹150

Debenture Interest Account

		₹		₹
Mar. 1	To Bank-Interest for 2 months on ₹ 5,000 Debentures	50	June 30 By Profit & Loss A/c	1,400
June 30	To Debenture-holders (Interest) A/c	1,350		
		1,400		1,400

Debenture-holders (Interest) Account

		₹			₹
June 30	To Cash	1,350	June 30	By Debenture interest Account (Interest on ₹ 45,000 @ 6% upto 30th June)	1,350

2nd Half Year

6% Debentures Account

		₹	₹			₹
Aug. 1	To Bank-Debenture Purchased		9,975	July 1	By Balance b/d	45,000
	To P & L A/c on Cancellation		25			

Dec. 15	To	Bank-Deb. Purchased	2,462.50					
	To	Profit & Loss on Cancellation of Debentures	37.50	2,500				
Dec. 31	To	Balance c/d		32,500				
				45,000				45,000

Profit & Loss on Cancellation of Debentures Account

			₹				₹
Dec. 31	To	Capital Reserve — Transfer	62.50	Aug. 1	By	Debenture A/c	25.00
				Dec. 15	By	Debenture A/c	37.50
			62.50				62.50

Debenture Interest Account

			₹				₹
Aug. 1	To	Bank - Interest for one month on ₹ 10,000	50.00	Dec.	By	P & L Account	1,093.75
Dec. 15	To	Bank	68.75				
Dec. 31	To	Debenture holders	975.00				
			1,093.75				1,093.75

Debenture-holders (Interest) Account

			₹				₹
Dec. 31	To	Bank	975.00	Dec. 31	By	Debenture Interest (on ₹ 32,500 @ 6% for 6 months)	975.00

Tutorial Notes :

(*i*) Profit or loss on redemption of debenture arises only on sale or cancellation; if debentures are purchased but not cancelled the total amount paid (minus the interest to the date of purchase) should be debited to Own Debentures Account and shown as investment in the Balance Sheet. On cancellation, the account will be credited and Debenture Account debited: the difference between the nominal value of the debentures cancelled and the amount standing to the debit on Own Debentures Account will be profit or loss on redemption of debentures.

(*ii*) If debentures are straightway cancelled on purchase, the profit or loss on redemption of debentures will be ascertained by comparing (*i*) the nominal value of debentures cancelled, and (*ii*) the price paid less interest to the date of purchase (if the transaction is cum-interest).

(*iii*) In case the transaction is ex-interest, the interest to the date of transaction will be paid in addition to the settled price and hence profit on redemption will be nominal value minus the settled price.

Illustration 2

The following balances appeared in the books of a company as on December 31, 2012: 6% Mortgage 10,000 debentures of ₹ 100 each; Debenture Redemption Reserve (for redemption of debentures) ₹ 10, 42,000; Investment ₹ 5,28,000, 4% Government Loan purchased at par and ₹ 5,60,000, 3-1/2% Government paper purchased for ₹ 5,42,000.

The Interest on debentures had been paid up to December 31, 2012.

On February 28, 2013, the investments were sold at ₹ 90 and ₹ 87 respectively and the debentures were paid off at 101, together with accrued interest.

Write up the ledger accounts concerned. The Debenture Redemption Reserve is non cumulative.

Solution

6% Mortgage Debentures Account

2013		₹	2013		₹
Feb. 28	To Debenture-holders A/c	10,00,000	Jan. 1	By Balance b/d	10,00,000

Premium on Redemption of Debentures Account

2013		₹	2013		₹
Feb. 28	To Debenture-holders A/c	10,000	Feb. 28	By D.R.R. A/c	10,000

Debentures Redemption Reserve Investment Account

2013		₹	*2013*		₹
Jan. 1	To Balance b/d	10,70,000	Feb. 28	By Bank ₹ 5,28,000 Govt. Loan @ ₹ 90	4,75,200
				By Bank ₹ 5,60,000 Govt. Paper @ ₹ 87	4,87,200
				By D.R.R. (Loss)	1,07,600
		10,70,000			10,70,000

Debenture Interest Account

2013		₹	2013		₹
Feb. 28	To Cash	10,000	Feb. 28	By Profit & Loss A/c	10,000

Cash Account

2013		₹	2013		₹
Feb.	To Balance b/d	?	Feb. 28	By Debenture-holders	10,10,000
	To Debentures Redemption Reserve investment A/c	9,62,400		By Deb. Interest A/c	10,000
				By Balance c/d	?

Debenture Redemption Reserve Account

2013		₹	2013		₹
Feb.	To D.R.R. Investment Account (Loss)	1,07,600	Jan. 1	By Balance b/d	10,42,000
	To Premium on Redemption of Debentures A/c	10,000		By Profit & Loss (Appropriation) A/c	75,600
	To General Reserve	10,00,000			
		11,17,600			11,17,600

Illustration 3

Sencom Limited issued ₹ 1,50,000 5% Debentures on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase debentures in the open market for cancellation thereof. The following purchases were made during the year ended 31st December, 2012 and the cancellation were made on the following 31st March :

1st March ₹ 25,000 nominal value purchased for ₹ 24,725 ex-interest.

1st September ₹ 20,000 nominal value purchased for ₹ 20,125 cum-interest.

You are required to draw up the following accounts up to the date of cancellation :

(i) Debentures Account;

(ii) Own Debenture Investment Account; and

(iii) Debenture Interest Account.

Ignore taxation and make calculations to the nearest rupee.

Solution

Sencom Limited
Debenture Account

2012		₹	2012		₹
Dec. 31	To Balance c/d	1,50,000	Jan. 1	By Balance b/d	1,50,000
2013			2013		
Mar. 31	To Own Debenture A/c	45,000	Jan. 1	By Balance b/d	1,50,000
	To Balance c/d	1,05,000			
		1,50,000			1,50,000
			April. 1	By Balance b/d	1,05,000

Own Debenture Investment Account

2012		Nominal Cost ₹	Interest ₹	Cost ₹	2012		Nominal Cost ₹	Interest ₹	Cost ₹
Mar. 1	To Bank	25,000	521	24,725	Mar. 31	By Debenture Interest A/c	—	625	—
Sep. 1	To Bank	20,000	417	19,708	Sep. 30	By Debenture Interest A/c	—	1,125	—
Dec. 31	To P & L A/c		1,375		Dec. 31	By Debenture Interest A/c	—	563	—
						By Balance c/d	45,000	—	44,433
		45,000	2,313	44,433			45,000	2,313	44,433
2013					2013				
Jan. 1	To Balance b/d	45,000		44,433	Mar. 31	By Debenture Interest A/c	—	563	—
Mar. 31	To Capital Reserve (Profit on cancellation)	—	—	567		By 5% Deb. A/c	45,000	—	45,000
	To P & L A/c	—	563	—					
		45,000	563	45,000			45,000	563	45,000

Debenture Interest Account

2012		₹	2012		₹
Mar. 31	To Bank (on ₹ 1,25,000 @ 5% for 6 months)	3,125	Jan.	By Accrued Interest (on ₹ 1,50,000 @ 5% for 3 months)	1,875
	To Interest on own Debentures	625	Dec. 31	By P & L A/c	7,500

Sep. 30	To	Bank (on ₹ 1,05,000 @ 5% for 6 months)	2,625				
	To	Interest on own Debentures	1,125				
Dec. 31	To	Interest accrued (on ₹ 1,05,000 for 3 months)	1,312				
	To	Interest on own debentures (on ₹ 45,000 for 3 months)	563				
			9,375				9,375
2013				2013			
Mar. 31	To	Bank (on ₹ 1,05,000 for 6 months)	2,625	Jan. 1	By	Interest Accrued	1,312
	To	Interest on own debentures (on ₹ 45,000 for 3 months)	563	Mar. 31	By	P & L A/c	1,876
			3,188				3,188

Illustration 4

Hindustan Ltd., issued 50,000, 6% Debentures of 100 each on 1st January, 2009. The debentures are redeemable by the creation of a Debenture Redemption Reserve. The company had the right to call upon the Trustee to apply the Debenture Redemption Reserve monies in purchasing own debentures, if available below par. The following information is given :

(a) *The annual appropriation is ₹ 50,000.*

(b) *Debenture Redemption Reserve Balance as on 1st January, 2012 was ₹ 1,31,942 represented by 6% State Loan at cost of ₹ 74,262 (face value ₹ 80,000) and Debenture Redemption Reserve cash ₹ 56,830. This cash balance which includes the annual appropriation of ₹ 50,000 was invested in 6% State Loan. The Loan bond, purchased cum interest, had a face value of ₹ 60,000.*

(c) *1st September, 2012 sold the State Loan of the face value ₹ 40,000 out of loan held on 1st January, 2012 ₹ 38,000 (ex-interest) and the proceeds were applied in purchasing own debentures (face value ₹ 45,000 ex-interest).*

(d) *The debentures purchased are cancelled on 31st December.*

(e) *Interest on State Loan is received on 31st March and 30th September.*

(f) *Interest on debentures is paid on 30th June and 31st December.*

(g) *Debentures outstanding as on 1st January, 2012 were ₹ 4,67,000.*

Make ledger entries in the books of the company to give effect to the above.

Solution

Debenture Redemption Reserve Account

2012		₹	2012		₹
Dec. 31	To General Reserve-transfer	45,000	Jan. 1	By Balance b/d	1,31,942
Dec. 31	To Balance c/d	1,52,761	Sep. 1	By D.R.R. Investment A/c-profit on sale	869
			Dec. 31	By Own Debentures-profit on cancellation	6,450
				By Interest on D.R.R. Investment A/c	8,500
				By Profit & Loss A/c	50,000
		1,97,761			1,97,761
			2013		
			Jan. 1	By Balance b/d	1,52,761

Debenture Redemption Reserve Investment Account 6% State Loan

2012		Face Value ₹	Cost ₹	2012		Face Value ₹	Cost ₹
Jan.1	To Balance b/d	80,000	74,262	Sep.1	By D.R.R. Cash A/c	40,000	38,000
	To D.R.R. Cash A/c	60,000	56,780	Dec. 31	By Balance c/d	1,00,000	93,911
Sep. 1	To D. R. R. A/c, profit on sale (assumed, FIFO basis)		869				
		1,40,000	1,31,911			1,40,000	1,31,911
2013							
Jan.1	To Balance b/d	1,00,000	93,911				

Own Debenture (D.R.R.) Account

2012		₹	₹	2012		₹	₹
Sep. 1	To D.R.R. Cash	45,000	38,550	Dec. 31	By Debentures A/c		
	To D.R.R. A/c, profit		6,450		(cancellation)	45,000	45,000
		45,000	45,000			45,000	45,000

Interest on D.R.R. Investment Account

2012		₹	2012		₹
Jan. 1	To Balance b/d (Interest on ₹ 80,000 for 3 months)	1,200	Mar. 31	By D.R.R. Cash (on ₹ 1,40,000 for 6 months)	4,200
Jan. 1	To D.R.R. Cash (on ₹ 60,000 for 3 months)	900	Sep. 1	By D.R.R. Cash (Interest on ₹ 40,000 for 5 months)	1,000
Dec. 31	To D. R. R. A/c, transfer	8,500	Sep. 30	By D.R.R. Cash (Interest on ₹ 1,00,000 for 6 months)	3,000
			Dec. 31	By Debenture Interest (on ₹ 45,000 for 4 months)	900
			Dec. 31	By Balance c/d (on ₹ 1,00,000 for 3 months)	1,500
		10,600			10,600
2013					
Jan. 1	To Balance b/d	1,500			

Debenture Interest Account

2012		₹	2012		₹
June 30	To Bank	14,010	Dec. 31	By P & L A/c, (transfer)	28,020
Sep. 1	To D.R.R. Cash (Interest on ₹ 45,000 Debentures for 2 months)	450			
Dec. 31	To Bank	12,660			
	To Interest on D.R.R. Investment (Interest on own debentures for ₹45,000 for 4 months)	900			
		28,020			28,020

Debenture Redemption Reserve Cash Account

2012		₹	2012		₹
Jan. 1	To Balance b/d	7,680	Jan. 1	By Interest of D.R.R.	

	To	Bank-transfer	50,000			Investment A/c	
Mar. 31	To	Interest on D.R.R. Investments	4,200			(on ₹ 60,000 for 3 months)	900
Sep. 1	To	D.R.R. Investment			By	D.R.R. Investment A/c	
		6% State Loan	38,000			6% State Loan	56,830
	To	Interest on D.R.R. Investments	1,000	Sep. 1	By	Debenture Interest A/c	450
					By	Own Deb. (D.R.R.) A/c	38,500
Sep. 30	To	Interest on D.R.R.		Dec.31	By	Balance c/d	7,200
		Investments	3,000				
			1,03,880				1,03,880
2013							
Jan. 1	To	Balance b/d	7,200				

6% Debentures Account

2012			₹	*2012*			₹
Dec. 31	To	Own Deb. (D.R.R.) A/c	45,000	Jan. 1	By	Balance b/d	4,67,000
Dec. 31	To	Balance c/d	4,22,000				
			4,67,000				4,67,000

Notes :

(1) The amount to be invested on Jan. 1, 2012 is ₹ 57,680; ₹ 60,000, 6% State Loan has been purchased. Interest till date on this loan is ₹ 900; this has been debited to the interest on D.R.R. investments Account and the balance; ₹ 56,780, debited to the D.R.R. Investments Account.

(2) The total amount realised by sale of ₹ 40,000 State loan on Sept. 1, 2012 is ₹ 39,000 *i.e.,* ₹ 38,000 *plus* ₹ 1,000 (interest for 5 months on ₹ 40,000).

(3) ₹ 39,000 is utilised for purchase of ₹ 45,000 own debentures; the interest till date is ₹ 450 — debited to Debenture Interest Account, ₹ 38,550 is debited to Own Debentures (D.R.R.) Account.

Illustration 5

MM Ltd. had the following among their ledger opening balances on January 1, 2012:

	₹
11% Debentures A/c (2000 issue)	*50,00,000*
Debenture Redemption Reserve A/c	*45,00,000*
13.5% Debentures in XX Ltd. A/c (Face Value ₹ 20,00,000)	*19,50,000*
Own Debentures A/c (Face value ₹ 20,00,000)	*18,50,000*

As 31st December, 2012 was the date for redemption of the 2000 debentures, the company started buying own debentures and made the following purchases in the open market :

1-2-2012 2,000 debentures at ₹ 98 cum-interest.

1-6-2012 2,000 debentures at ₹ 99 ex-interest.

Half yearly interest is due on the debentures on the 30th June and 31st December in the case of both the companies.

On 31st December, 2012, the debentures in XX Ltd. were sold for ₹ 95 each ex-interest. On that date, the outstanding debentures of MM Ltd. were redeemed by payment and by cancellation.

Show the entries in the following ledger accounts of MM Ltd. during 2012 :

(a) Debenture Redemption Reserve A/c

(b) Own Debentures A/c

The face value of a debenture was ₹ 100 (Round off calculations to the nearest rupee.)

Solution

(*a*) **Debenture Redemption Reserve Account**

2012		₹	*2012*		₹
Dec. 31	To 13.5% Deb. in XX Ltd.		Jan. 1	By Balance b/d	45,00,000
	(Loss on sale of		Dec. 31	By 13.5% Deb. in	
	investment)	50,000		XX Ltd.	2,70,000
	To General Reserve(transfer)	49,73,000		By Own Deb. A/c (Int. on own Deb.)	2,53,000
		50,23,000			50,23,000

11% Debentures Account

2012		₹	*2012*		₹
Dec. 31	To Own Debentures A/c	24,00,000	Jan. 1	By Balance b/d	50,00,000

	To Bank	26,00,000			
		50,00,000			50,00,000

(b) **Own Debentures Account**

		Nominal	Int.	Amt.			Nominal	Int.	Amt.
2012		₹	₹	₹	2012		₹	₹	₹
Jan. 1	To Balance b/d	20,00,000	-	18,50,000	June 30	By Debenture			
Feb. 1	To Bank	2,00,000	1,833	1,94,167		Int. A/c		1,32,000	
June 1	To Bank	2,00,000	9,167	1,98,000	Dec. 31	By Debenture			
Dec. 31	To Capital Res.					Int. A/c		1,32,000	
	(profit on					By 11% Deb	24,00,000		
	cancellation)			1,57,833		Account, cancellation			24,00,000
	To. Deb. Redemp Reserve		2,53,000						
		24,00,000	2,64,000	24,00,000			24,00,000	2,64,000	24,00,000

Working Note :

13.5% Debentures in XX Ltd.

		Interest	Amount			Interest	Amount
2012		₹	₹	2012		₹	₹
Jan. 1	To Balance b/d			June 30	By Bank	1,35,000	
	(20,00,000)		19,50,000	Dec. 31	By Bank	1,35,000	
Dec. 31	To Debenture				By Bank		19,00,000
	Redemp. Reserve	2,70,000			By Debenture Redemp.		
					Reserve		
					(Loss on sale)		50,000
		2,70,000	19,50,000			2,70,000	19,50,000

Illustration 6

(i) *Swati Associates Ltd. has issued 10,000 12% Debentures of ₹ 100 each on 1-1-2010. These debentures are redeemable after 3 years at a premium of ₹ 5 per debenture. Interest is payable annually.*

(ii) *On October 1, 2011, it buys 1,500 debentures from the market at ₹ 98 per debenture. These are sold away on June 30, 2012 at ₹ 105 per debenture.*

(iii) On January 1, 2012 it buys 1,000 debentures at ₹ 104 per debenture from the open market. These are cancelled on April 1, 2012.

(iv) On October 1, 2012 it buys 2,000 debentures at ₹ 106 per debenture from the open market. These debentures along with other debentures are redeemed on 31st December, 2012.

Prepare the relevant Ledger Accounts showing the above transactions. Workings should form part of your answer.

Solution

12% Own Debentures Account

2011		Interest ₹	Amount ₹	2011		Interest ₹	Amount ₹
Oct. 1	To Bank (₹ 1,50,000)	13,500	1,47,000	Dec. 31	By Debenture Int. A/c	18,000	
	To Profit & Loss A/c	4,500			By Balance c/d		1,47,000
		18,000	1,47,000			18,000	1,47,000
2012				2012			
Jan. 1	To Balance b/d		1,47,000	Apl. 1	By Debenture Int. A/c	3,000	
Jan. 1	To Bank		1,04,000		By 12% Deb. A/c		1,00,000
Apl. 1	To Profit & Loss A/c	3,000			By Profit & Loss A/c		4,000
June 30	To Profit & Loss A/c	9,000	10,500	June 30	By Bank	9,000	1,57,500
Oct. 1	To Bank (₹ 2,00,000)	18,000	2,12,000	Dec. 31	By Deb. Int. A/c	24,000	
Dec.31	To Profit & Loss A/c	6,000			By 12% Deb. A/c (cancelled)		2,00,000
					By Profit & Loss A/c		12,000
		36,000	4,73,500			36,000	4,73,500

Note : It has been assumed that all transactions are ex-interest. The amount of such interest has been calculated from the previous 1st January to the date of transaction since the interest is payable annually.

Debenture Interest Account

2010		₹	*2010*		₹
Dec. 31	To Bank A/c	1,20,000	Dec. 31	By Profit & Loss A/c	1,20,000
2011			2011		
Dec. 31	To Bank A/c	1,02,000	Dec. 31	By Profit & Loss A/c	1,20,000
	To Int. on Own Deb. A/c	18,000			
		1,20,000			1,20,000
2012			2012		
Apl.1	To Int. on Own Deb. A/c	3,000	Dec. 31	By Profit & Loss A/c	1,11,000
Dec. 31	To Int. on Own Deb. A/c	24,000			

	To Bank A/c (12% on ₹ 7,00,000)	84,000			
		1,11,000			1,11,000

Statement of Profit & Loss (Extracts) for the year 2010

Particulars	*Notes*	*Amount*
Expenses		
Finance costs	xx	1,20,000
Total expenses		……
Notes to accounts		
xx. Finance costs		
Interest on debenture		1,20,000

Statement of Profit & Loss (Extracts) for the year 2011

Particulars	*Notes*	*Amount*
Other Income	xx	4,500
Total Revenue		……
Expenses		
Finance costs	xxx	1,20,000
Total expenses		……
Notes to accounts		
xx. Other Income		
Int. on Own Deb. A/c (18,000 - 13,500)		4,500
xxx. Finance costs		
Interest on debenture		1,20,000

Statement of Profit & Loss (Extracts) for the year 2012

Particulars	*Notes*	*Amount*
Other Income	xx	28,500
Total Revenue		
Expenses		
Finance costs	xxx	51,000
Total expenses		
Notes to accounts		
xx. Other Income		
Int. on Own Deb. A/c (36,000 - 18,000)		18,000
Profit on cancellation of debentures		10,500
Total		**28,500**

xxx. Finance costs		
Loss on cancellation of debentures (4,000 + 12,000)		16,000
Premium on redemption of debentures (₹ 7,00,000 @ 5%)		35,000
Total		**51,000**

Premium on Redemption of Debentures A/c

2010			*2010*		
Dec. 31	To Bank	35,000	Dec. 31	By Profit & Loss A/c	35,000

12% Debentures Account

2010		₹	*2010*		₹
Dec. 31	To Balance c/d	10,00,000	Jan. 1	By Bank	10,00,000
2011			2011		
Dec. 31	To Balance c/d	10,00,000	Jan. 1	By Balance b/d	10,00,000
2012			2012		
Apl. 1	To Own Deb. A/c	1,00,000	Jan. 1	By Balance b/d	10,00,000
Dec. 31	To Own Deb. A/c	2,00,000			
	To Bank	7,00,000			
		10,00,000			10,00,000

Working Notes :

(*i*) Interest paid on purchase of own debentures:

Date	*Nominal Amount*	*Period*	*Rate*	*Interest*
2011 Oct. 1	₹ 1,50,000	9 months	12%	13,500
2012 Oct. 1	₹ 2,00,000	9 months	12%	18,000

(*ii*) Interest credited to Interest on Own Debenture A/c

2011 Dec. 31	₹ 1,50,000	12 months	12%	18,000
2012 April 1	₹ 1,00,000	3 months	12%	3,000
2012 June 30	₹ 1,50,000	6 months	12%	9,000
2012 Dec. 31	₹ 2,00,000	12 months	12%	24,000

(*iii*) Profit/Loss on cancellation/sales is difference between cost or nominal value and sales price.

Illustration 7

The Summary Balance Sheet of Chanjit Ltd. at March 31, 2012 was :

	₹		₹
Issued and Fully Paid		*Sundry Assets*	*21,55,000*
Share Capital :		*Own Debentures (Nominal*	*1,05,000*

		₹ 1,20,000)	
50,000 6%Redeemable 'A' Pref.		*Cash at Bank*	*5,80,000*
Shares of ₹ 10 each	*5,00,000*		
40,000 7% Redeemable 'B' Pref.			
Shares of ₹ 10 each (less calls			
in arrear on 5,000 shares@ ₹ 1)	*3,95,000*		
50,000 Equity shares of ₹ 10 each	*5,00,000*		
Securities Premium Account	*1,00,000*		
Capital Reserve Account	*1,00,000*		
Profit and Loss Account	*4,00,000*		
General Reserve Account	*2,00,000*		
5% Debentures	*4,00,000*		
Trade Payables	*2,45,000*		
	28,40,000		*28,40,000*

On September 30, 2012 following were due for redemption :

(1) The ₹ 4,00,000 5% Debentures at a premium of 10 per cent.

(2) The ₹ 5,00,000 6% 'A' Preference Shares at a premium of ₹ 1 per share.

(3) The ₹ 4,00,000 7% 'B' Preference Shares at a premium of 5 per cent.

It was decided :

(a) Out of the trading profits of ₹ 2,00,000 earned in the seven months to Oct. 31, 2012, to pay the debenture interest and preference dividends for the half year to September 30, 2012;

(b) to offer to the debenture holders new 6% debentures 2012 or repayment in cash. The offer of new debentures in exchange for the original holding was accepted by 50 per cent of the debenture holders including those held by Chanjit Ltd. The whole transaction was completed on September 30, 2012;

(c) A transfer was made to General Reserve of a sum equivalent to the nominal value of redemption;

(d) to make an issue of 60,000 Equity Shares of ₹ 10 each at a premium of ₹ 2.50 per share. This was done on August 31, 2012 and all moneys were received on that date;

(e) to repay in cash both 'A' and 'B' Preference shares, and this was carried through on September 30, 2012.

You are required to (1) show the ledger accounts recording the above transaction in the company books and (2) give the company's Balance Sheet at Oct. 31, 2012. Ignore expenses and taxation.

Solution:

5% Debentures Account

2012		₹	2012		₹
Sep. 30	To Debenture holders Account	4,00,000	Apl. 1	By Balance b/d	4,00,000
		4,00,000			4,00,000

Old 5% Own Debentures Account

2012		₹	2012		₹
Apl. 1	To Balance b/d	1,05,000	Sep. 30	By New Own 6% Deb. A/c (nominal value ₹1,32,000)	1,05,000

(New) 6% Own Debentures Account

2012		₹	2012		₹
Sep. 30	To (Old) 5% Own Deb. A/c	1,05,000	Sep. 30	By Balance c/d	1,05,000
		1,05,000			1,05,000

6% Debentures Account

2012		₹	2012		₹
Oct. 31	To Balance c/d	2,20,000	Sep. 30	By Debentures A/c	2,20,000
		2,20,000			2,20,000

Debenture holders Account

2012		₹	2012		₹
Sep. 30	To Bank A/c	2,20,000	Sep. 30	By 5% Debentures A/c	4,00,000
	To 6% Debentures	2,20,000		By Premium on Redemp. of Debentures A/c	40,000
		4,40,000			4,40,000

General Reserve Account

2012		₹	2012		₹
Oct. 31	To Balance c/d	4,00,000	Apl. 1	By Balance b/d	2,00,000
			Sep. 30	By Profit & Loss A/c	2,00,000
		4,00,000			4,00,000
			Nov. 1	By Balance b/d	4,00,000

Statement of Profit & Loss (Extract) for the year 2012

Other income	x	3,000
Total		…….
Expenses:		
Finance Costs	Xx	10,000
Total expenses		……
Profit/ (Loss) for the period (200,000-7,000)		**1,93,000**
Notes to accounts		
x Other income		
Interest on own debentures		3,000
xx Finance costs		
Interest on 5% Debentures		10,000

Note : It has been assumed that cash balance has increased by the sum of profit earned.

Equity Share Capital Account

2012		₹	2012		₹
Oct. 31	To Balance c/d	11,00,000	Apl. 1	By Balance b/d	5,00,000
			Aug. 31	By Bank A/c	6,00,000
		11,00,000			11,00,000
			Nov. 1	By Balance b/d	11,00,000

Securities Premium Account

2012		₹	2012		₹
Sep. 30	To Premium on Redemp. of Preference Shares A/c	70,000	Apl. 1	By Balance b/d	1,00,000
			Aug. 30	By Bank A/c	1,50,000
	To Premium on Redemp. of Debentures A/c	40,000			
	To Balance c/d	1,40,000			
		2,50,000			2,50,000
			Nov. 1	By Balance b/d	1,60,000

Cash at Bank

2012		₹	2012		₹
Apl. 1	To Balance b/d	5,80,000	Sep. 30	By 6% 'A' Preference Shareholders A/c	5,50,000
Aug. 31	To Equity Share Capital A/c	6,00,000		7% 'B' Preference Shareholders A/c	3,67,500
	To Securities Premium A/c	1,50,000			
Oct. 31	To Profit & Loss A/c	2,00,000			

	(assumed to be earned in cash)			By 5% Debentureholders Account	2,20,000
				By Pref. Dividend A/c	29,000
				By Interest on 5% Deb. A/c (10,000-3,000)	7,000
			Oct. 31	By Balance c/d	3,56,500
		15,30,000			15,30,000
Nov.1	To Balance b/d	3,56,500			

7% 'B' Preference Shareholders Account

2012		₹	2012		₹
Sep. 30	To Bank A/c	3,67,500	Sep. 30	By 7% 'A' Preference Shares Capital A/c (35,000 shares)	3,50,000
				By Premium on Redemp. of Pref. Shares A/c	17,500
		3,67,500			3,67,500

6% 'A' Preference Shareholders Account

2012		₹	2012		₹
Sep. 30	To Bank A/c	5,50,000	Sep. 30	By 6% 'A' Preference Share Capital A/c	5,00,000
				By Premium on Redemp. of Pref. Shares A/c	50,000
		5,50,000			5,50,000

Premium on Redemption of Preference Shares Account

2012		₹	2012		₹
Sep. 30	To 6% 'A' Pref. Shareholders Account	50,000	Sep.30	By Securities Premium A/c	70,000
	To 7% 'B' Pref. Shareholders Account	17,500			
	To Balance c/d	2,500			
		70,000			70,000
			Oct. 1	By Balance b/d	2,500

Premium on Redemption of Debentures Account

2012		₹	2012		₹
Sep. 30	To 5% Debentureholders	20,000	Sep. 30	By Securities Premium A/c	20,000

Capital Redemption Reserve Account

2012		₹	2012		₹
Oct. 31	To Balance c/d	3,00,000	Sep. 30	By Profit & Loss A/c	3,00,000
			Nov. 1	By Balance b/d	3,00,000

Balance Sheet of Chanjit Ltd. as on 31st Oct., 2012

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	11,45,000
(b) Reserves and Surplus	2	10,04,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	2,20,000
(3) Current Liabilities		
(a) Trade payables		2,45,000
(b) Short-term provisions	4	2,500
Total		26,16,500
II. Assets		
(1) Non-current assets		
(a) Fixed assets		21,55,000
(b) Non-current investments	5	1,05,000
(2) Current assets		
Cash and Cash equivalents		3,56,500
Total		26,16,500

Notes to Accounts

			₹
1	**Share Capital**		
	Authorised, Issued and Subscribed		
	1,10,000 Equity Shares of ₹ 10 each fully paid up		11,00,000

	7% Redeemable 'B' Pref. Shares (pending redemption)	50,000	
	Less : Calls in arrear	(5,000)	45,000
			11,45,000
2	**Reserve and Surplus**		
	Capital Reserve		1,00,000
	Capital Redemption Reserve A/c		3,00,000
	Securities Premium		1,40,000
	General Reserve		4,00,000
	Profit & Loss Account	1,93,000	
	Add: Balance from previous year	4,00,000	
		5,93,000	
	Less: Preference Dividend	29,000	
	Transfer to General Reserve	(2,00,000)	
	Transfer to Capital Redemption Reserve	(3,00,000)	
	Profit (Loss) carried forward to Balance Sheet		64,000
			10,04,000
3	**Long-term borrowings**		
	Secured Loans : 6% Debentures		2,20,000
4	**Short-term provisions**		
	Premium payable on redemption of 5,000 B Preference Shares		2,500
5	**Non-current investments**		
	Own Debenture (Nominal Value 1,32,000)		1,05,000

Illustration 8

The Summary Balance Sheet of BEE Co. Ltd. on 31st March, 2012 read as under :

Liabilities	*₹*	*Assets*	*₹*
Share Capital :		*Freehold property*	*1,15,000*
Authorised:		*Stock*	*1,35,000*
30,000 Equity Shares of ₹ 10 each	*3,00,000*	*Trade receivables*	*75,000*
Issued and Subscribed:		*Cash*	*30,000*
20,000 Equity Shares of ₹ 10 each		*Balance at Bank*	*2,20,000*
fully paid	*2,00,000*		
Profit and Loss Account	*1,20,000*		
12% Debentures	*1,20,000*		

Trade payables	*1,15,000*		
Proposed Dividends	*20,000*		
	5,75,000		*5,75,000*

At the Annual General Meeting it was resolved :

(a) To pay the proposed dividend of 10 per cent in cash.

(b) To give existing shareholders the option to purchase one ₹ 10 share at ₹ 15 for every four shares (held prior to the bonus distribution), this option being taken up by all shareholders.

(c) To issue one bonus share for every four shares held.

(d) To repay the debentures at a premium of 3 per cent.

Give the necessary journal entries and the company's Balance Sheet after these transactions are completed.

Solution

Journal of BEE Co. Ltd.

		Dr. ₹	Cr. ₹
Proposed Dividend A/c	Dr.	20,000	
To Bank A/c			20,000
(Proposed Dividend paid to existing shareholders)			
Bank A/c	Dr.	75,000	
To Equity Shareholders A/c			75,000
(Application money received on 5,000 shares @ ₹ 15 per share to be issued as rights shares in the ratio of 1:4)			
Equity Shareholders A/c	Dr.	75,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			25,000
(Share application money on 5,000 shares @ ₹ 10 per share transferred to Share Capital Account, and ₹ 5 per share to Securities Premium Account vide Board's Resolution dated….)			
Securities Premium A/c	Dr.	25,000	
Profit & Loss A/c	Dr.	25,000	
To Bonus to Shareholders A/c			50,000
(Amount transferred for issue of bonus shares to existing shareholders in the ratio of 1:4 *vide* General Body's resolution dated...)			

Bonus to Shareholders A/c	Dr.	50,000	
To Equity Share Capital A/c			50,000
(Issue of bonus shares in the ratio of 1 for 4 *vide* Board's resolution dated....)			
12% Debentures A/c	Dr.	1,20,000	
Premium Payable on Redemption A/c	Dr.	3,600	
To Debenture holders A/c			1,23,600
(Amount payable to debentures holders)			
Profit & Loss A/c	Dr.	3,600	
To Premium Payable on Redemption A/c			3,600
(Premium payable on redemption charged to Profit & Loss A/c)			
Debenture holders A/c	Dr.	1,23,600	
To Bank A/c			1,23,600
(Amount paid to debenture holders on redemption)			

Balance Sheet of BEE Co. Ltd. as on...... (after completion of transactions)

Particulars	Note No	₹
I. Equity and liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	3,00,000
(b) Reserves and Surplus	2	91,400
(2) Current Liabilities		
(a) Trade payables		1,15,000
Total		5,06,400
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible Assets	3	1,15,000
(2) Current assets		
(a) Inventories		1,35,000
(b) Trade receivables		75,000
(c) Cash and cash equivalents	4	1,81,400
Total		5,06,400

Notes to Accounts

			₹
1.	**Share Capital**		
	30,000 shares of ₹ 10 each fully paid (5,000 shares of ₹ 10 each, fully paid issued as bonus shares out of securities premium and P&L Account)		3,00,000
2.	**Reserve and Surplus**		
	Profit & Loss Account (1,20,000 – 3,600)	1,16,400	
	Less: Utilisation for issue of bonus shares	(25,000)	91,400
3.	**Tangible assets**		
	Freehold Property		1,15,000
4.	**Cash and cash equivalents**		
	Cash at Bank	1,51,400	
	Cash in Hand	30,000	1,81,400

Note : The number of bonus shares issued has been calculated on the basis of issued capital before rights issued *i.e.,* 20,000 shares (and not 25,000 shares after rights issue).

Illustration 9

The summarised Balance Sheet of Convertible Limited, as on 30th June, 2012, stood as follows:

Liabilities	*₹*
Share Capital : 5,00,000 equity shares of ₹ 10 each fully paid	*50,00,000*
General Reserve	*75,00,000*
Debenture Redemption Reserve	*50,00,000*
13.5% Convertible Debentures, 1,00,000 Debentures of ₹ 100 each	*1,00,00,000*
Other loans	*50,00,000*
Current Liabilities and Provisions	*1,25,00,000*
	4,50,00,000
Assets :	
Fixed Assets (at cost less depreciation)	*1,60,00,000*
Debenture Redemption Reserve Investments	*40,00,000*
Cash and bank Balances	*50,00,000*
Other Current Assets	*2,00,00,000*
	4,50,00,000

The debentures are due for redemption on 1st July, 2012. The terms of issue of debentures provided that they were redeemable at a premium 5% and also conferred option to the

debenture holders to convert 20% of their holding into equity shares at a predetermined price of ₹ 15.75 per share and the payment in cash.

Assuming that :

(i) except for 100 debenture holders holding totally 25,000 debentures, the rest of them exercised the option for maximum conversion.

(ii) the investments realise ₹ 44 lakhs on sale; and

(iii) all the transactions are put through, without any lag, on 1st July, 2012.

Redraft the balance sheet of the company as on 1st July, 2012 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the cash payment necessary.

Solution

Convertible Limited
Balance Sheet as on July 1, 2012

Particulars	Note No	Figures as at the end of current reporting period
		₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	60,00,000
(b) Reserves and Surplus	2	1,29,75,000
(2) Non-Current Liabilities		
(a) Long-term borrowings - Unsecured Loans		50,00,000
(3) Current Liabilities		
(a) Short-term provisions		1,25,00,000
Total		3,64,75,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets		1,60,00,000
(2) Current assets		
(a) Cash and cash equivalents		4,75,000
(b) Other current assets		2,00,00,000
Total		3,64,75,000

Notes to Accounts

			₹
1.	**Share Capital**		
	6,00,000 Equity Shares of ₹ 10 each		60,00,000
2.	**Reserves and Surplus**		
	General Reserve	75,00,000	
	Add : Debenture Redemption Reserve transfer	50,00,000	
		1,25,00,000	
	Add: Profit on sale of investments	4,00,000	
		1,29,00,000	
	Less : Premium on redemption of debentures	(5,00,000)	1,24,00,000
	Securities Premium Account		5,75,000
			1,29,75,000

Working Notes :

(i) Calculation of number of shares to be allotted :

Total number of debentures	1,00,000
Less : Number of debentures not opting for conversion	(25,000)
	75,000
20% of 75,000	(15,000)
Redemption value of 15,000 debentures	₹ 15,75,000

Number of Equity Shares to be allotted :

$$= \frac{15,75,000}{15.75} = 1,00,000 \text{ shares of ₹ 10 each.}$$

(ii) Calculation of cash to be paid :

	₹
Number of debentures	1,00,000
Less : number of debentures to be converted into equity shares	(15,000)
	85,000
Redemption value of 85,000 debentures (85,000 × ₹ 105)	₹ 89,25,000

(iii) Cash and Bank Balance :

Balance before redemption	50,00,000
Add : Proceeds of investments sold	44,00,000
	94,00,000
Less : Cash paid to debenture holders	(89,25,000)
	4,75,000

Note : The premium on redemption of debentures can also be adjusted against Securities Premium Account.

Summary

- Debenture creates a charge against some or all the assets of the company.
- Charge may be fixed or floating, depends upon the condition of issue.
- Debentures may be redeemed after a fixed number of years or after a certain period has elapsed.
- For redemption of Debentures a company shall maintain Debenture Redemption Reserve

Unit – 4 : Amalgamation and Reconstruction

Learning Objectives

- After studying this unit, you will be able to solve the advanced problems on amalgamation and reconstruction of companies

4.1 Amalgamation

In an amalgamation, two or more companies are combined into one by merger or by one taking over the other. Therefore, the term 'amalgamation' contemplates two kinds of activities:

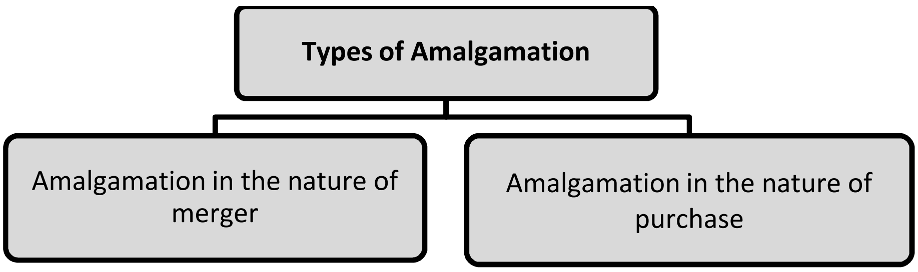
(*i*) two or more companies join to form a new company or

(*ii*) absorption and blending of one by the other.

Thus, amalgamations include absorption.

4.1.1 Types of Amalgamation

The Companies Act, 2013* has not specifically defined the term 'amalgamation' although it covers mergers and amalgamations in section 232 under the chapter XV on Compromises, Arrangements and Amalgamations. However, from several legal decisions, the definition of amalgamation may be inferred. The Institute of Chartered Accountants of India has introduced Accounting Standard -14 (AS 14) on 'Accounting for Amalgamations'. The standard recognizes two types of amalgamation –



4.2 Reconstruction

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. The object of reconstruction is usually to reorganize capital by writing off unrepresentative value of assets, restructure its capital needs under a rehabilitation plan and fund the same

***** *It may be noted that most of the sections related with corporate restructuring have not been notified till 31st May, 2015. Therefore, the corresponding sections of the companies Act, 1956 are still applicable at present.***

accordingly, settle dues with creditors by driving discounts and cuts and to effect economies in operations. Such a process is called ***internal reconstruction*** which is carried out without liquidating the company and forming a new one.

The other process of amalgamating the company or merge it with another under a scheme of reconstruction and rehabilitation is called ***External Reconstruction***

You must have studied the concepts of amalgamation and reconstruction of companies in Chapters 5 and 6 in Paper 1 Accounting of Intermediate (IPC) Course – Group I. In this unit, we will deal with some advanced problems for advanced knowledge on the topic.

4.3 Advanced Problems

Amalgamation of Companies

Illustration 1

Following are the summarised Balance Sheets of A Ltd. and B Ltd. as at 31.3.2012:

Particulars	*A Ltd.*	*B Ltd.*
Share capital: Equity shares 10 each (fully paid up)	*10,00,000*	*6,00,000*
Securities premium	*2,00,000*	----
General reserve	*3,00,000*	*2,50,000*
Profit and loss account	*1,80,000*	*1,60,000*
10% Debentures	*5,00,000*	----
Secured loan	-----	*3,00,000*
Trade payables	*2,60,000*	*1,70,000*
	24,40,000	*14,80,000*
Land and building	*9,00,000*	*4,50,000*
Plant and machinery	*5,00,000*	*3,80,000*
Investment	*80,000*	----
Inventory	*5,20,000*	*3,50,000*
Trade receivables	*4,10,000*	*2,60,000*
Cash at bank	*30,000*	*40,000*
	24,40,000	*14,80,000*

The companies agree on a scheme of amalgamation on the following terms:

(i) *A new company is to be formed by name AB Ltd.*

(ii) *AB Ltd. to take over all the assets and liabilities of the existing companies.*

(iii) *For the purpose of amalgamation, the shares of the existing companies are to be valued as under:*

A Ltd. = ₹ 18 per share

B Ltd. = ₹ 20 per share

(iv) A contingent liability of A Ltd. of ₹ 60,000 is to be treated as actual existing liability.

(v) The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of AB Ltd. at a premium of ₹ 6 per share.

(vi) The face value of shares of AB Ltd. are to be of ₹ 10 each.

You are required to:

(i) Calculate the purchase consideration (i.e., number of shares to be issued to A Ltd. and B Ltd.).

(ii) Pass journal entries in the books of A Ltd. for the transfer of assets and liabilities.

(iii) Pass journal entries in the books of AB Ltd. for acquisition of A Ltd. and B Ltd.

(iv) Prepare the Balance Sheet of AB Ltd.

Answer

(i) Statement showing calculation of purchase consideration

	(Number of shares)	
	A Ltd.	*B. Ltd.*
Existing shares	1,00,000	60,000
Value per share	₹ 18	₹ 20
Total value	₹ 18,00,000	₹ 12,00,000
No. of shares to be issued at a premium of ₹ 6 per share i.e. ₹ 16 (10+6)	1,12,500 shares	75,000 shares
	₹	₹
Share capital	11,25,000	7,50,000
Add: Securities premium	6,75,000	4,50,000
Total purchase consideration	18,00,000	12,00,000

(ii) Journal Entries in the books of A Ltd.

		₹	₹
Realisation A/c	Dr.	24,40,000	
To Land & building			9,00,000
To Plant & machinery			5,00,000
To Inventory			5,20,000
To Trade receivables			4,10,000
To Investment			80,000
To Bank			30,000
(Being assets transferred to Realisation A/c)			
Profit and loss A/c	Dr.	60,000	
ToTrade payables			60,000
(Being contingent liability treated as real liability)			

10% Debentures A/c	Dr.	5,00,000	
Trade payables A/c	Dr.	3,20,000	
To Realisation A/c			8,20,000
(Being transfer of liabilities to Realisation A/c)			
AB Ltd.	Dr.	18,00,000	
To Realisation A/c			18,00,000
(Being the purchase consideration accounted for)			
Share in AB Ltd. A/c	Dr.	18,00,000	
To AB Ltd.			18,00,000
(Being purchase consideration received)			
Share Capital A/c	Dr.	10,00,000	
Securities premium A/c	Dr.	2,00,000	
General Reserve A/c	Dr.	3,00,000	
Profit and Loss A/c	Dr.	1,20,000	
Realisation A/c	Dr.	1,80,000	
To Shareholders A/c			18,00,000
(Being transfer of balances to shareholders' account)			
Shareholders A/c	Dr.	18,00,000	
To Shares in AB Ltd.			18,00,000
(Being closure of shareholders a/c)			

(iii) Journal Entries in the Books of AB Ltd.

		₹	₹
Land & building A/c	Dr.	9,00,000	
Plant & machinery A/c	Dr.	5,00,000	
Investment A/c	Dr.	80,000	
Inventory	Dr.	5,20,000	
Trade receivables	Dr.	4,10,000	
Bank	Dr.	30,000	
Goodwill	Dr.	1,80,000	
To 10% Debentures			5,00,000
To Trade payables			3,20,000
To Liquidator of A Ltd.			18,00,000
(Being the purchase consideration of A Ltd. accounted for)			
Land & building A/c	Dr.	4,50,000	
Plant & machinery A/c	Dr.	3,80,000	
Inventory A/c	Dr.	3,50,000	

Trade receivables A/c	Dr.	2,60,000	
Bank A/c	Dr.	40,000	
Goodwill A/c	Dr.	1,90,000	
To Secured loan A/c			3,00,000
To Trade payables			1,70,000
To Liquidator of B Ltd.			12,00,000
(Being purchase consideration of B Ltd. accounted for)			
Liquidator of A Ltd.	Dr.	18,00,000	
To Equity share capital			11,25,000
To Securities premium			6,75,000
(Being shares issued to Liquidator of A Ltd.)			
Liquidator of B Ltd. A/c	Dr.	12,00,000	
To Equity share capital			7,50,000
To Securities premium			4,50,000
(Being shares issued to Liquidator of B Ltd.)			

(iv) **Balance Sheet of AB Ltd.**
(After amalgamation of A Ltd. & B Ltd.)

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	18,75,000
(b) Reserves and Surplus	2	11,25,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	8,00,000
(3) Current Liabilities		
(a) Trade payables		4,90,000
Total		42,90,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	
Tangible assets		22,30,000
Intangible assets		3,70,000
(b) Non-current investment		80,000

(2) Current assets		
(a) Inventories		8,70,000
(b) Trade receivables		6,70,000
(c) Cash and cash equivalents	5	70,000
Total		42,90,000

Notes to Accounts

			₹
1.	**Share Capital**		
	1,87,500 Equity shares of ₹ 10 each fully paid up (above shares have been issued for consideration other than cash)		18,75,000
2.	**Reserve and Surplus**		
	Securities premium		11,25,000
3.	**Long Term Borrowings**		
	Secured		
	10% Debentures	5,00,000	
	Secured loan	3,00,000	8,00,000
4.	**Fixed Assets**		
	(i) Tangible assets		
	Land & Building	13,50,000	
	Plant and Machinery	8,80,000	22,30,000
	(ii) Intangible assets		
	Goodwill (1,80,000 + 1,90,000)		3,70,000
5.	**Cash and Cash Equivalents**		
	Cash at Bank		70,000

Illustration 2

A Ltd. agreed to acquire the business of B Ltd. as on 31st December, 2011. On that date Balance Sheet of B Ltd. was summarized as follows:

Liabilities	₹	*Assets*	₹
Share Capital (Fully paid shares of ₹ 10 each)	*3,00,000*	*Goodwill*	*50,000*
		Land, Building and Plant	*3,20,000*
General Reserve	*85,000*	*Inventory*	*84,000*
P & L A/c	*55,000*	*Trade receivables*	*18,000*
6% Debentures	*50,000*	*Cash & Bank Balance*	*28,000*
Trade payables	*10,000*		
	5,00,000		*5,00,000*

The Debenture holders agreed to receive such 7% Debentures issued as 96 each as would discharge the debentures in B Ltd. at a premium of 20%. The shareholders in B Ltd. were to receive ₹ 2.50 in cash per share and 3 shares in A Ltd. for every two shares held – the shares in A Ltd. being considered as worth ₹ 12.50 each.

There were fractions equaling 50 shares for which each was paid. The directors of A Ltd. considered the various assets to be valued as follows:

	₹
Land	*1,00,000*
Buildings	*2,50,000*
Plant	*3,50,000*
Inventory	*80,000*
Trade receivables	*18,000*

The cost of liquidation of B Ltd. ultimately was ₹ 5,000. Due to a technical hitch, the transaction could be completed only on 1st July, 2011. Till date B Ltd. carried on trading which resulted in a profit ₹ 20,000 (subject to interest) after providing ₹ 15,000 as depreciation. On 30th June, 2011 Inventory was ₹ 90,000.Trade receivables were ₹ 25,000 and Trade payables were ₹ 15,000. There was no addition to or deletion from the fixed assets. It was agreed that the profit should belong to A Ltd.

You are required, as on July 1, 2012, to:

(i) prepare Realisation Account and the Shareholders Account in the ledger of B Ltd., and

(ii) give journal entries in the books of A Ltd.

Solution

Ledger of B Ltd.

Realisation Account

		₹			₹
To	Sundry Assets, transfer :		By	Trade payables	15,000
	Goodwill	50,000	By	6% Debentures	50,000
	Land, Building, Plant, etc.	3,20,000	By	A Ltd. - purchase consideration (2)	6,37,500
To	Inventory	90,000			
To	Trade receivable	25,000	By	Provision for Depreciation	15,000
To	Cash & Bank Balance (1)	55,000	By	A Ltd. [for profit (3)]	20,000
To	Shareholders - profit	1,97,500			
		7,37,500			7,37,500

Shareholders Account

	₹		₹
To Cash	75,625	By Share Capital A/c - transfer	3,00,000
To Shares in A Ltd.	5,61,875	By General Reserve	85,000
		By P & L A/c	55,000
		By Realisation A/c	1,97,500
	6,37,500		6,37,500

Note : It is clear that the costs of liquidation will be payable by A Ltd. since the amount payable to the shareholders has been specified.

		₹	₹
(1)	Cash and Bank Balances as on Jan. 1, 2012		28,000
	Add: Profit earned		20,000
	Depreciation provided (no cash payment)		15,000
	Increase in Trade payables		5,000
			68,000
	Less: Increase in Inventory	6,000	
	Increase inTrade receivables	7,000	(13,000)
			55,000
(2)	Purchase Consideration:		
	For Shareholders — Cash 30,000 × ₹ 2.50		75,000
	— Shares 30,000 × 3/2 – 50 = 44,950 @ ₹ 12.5		5,61,875
	— Cash for fractions of shares 50 @ ₹ 12.50		625
			6,37,500

(3) Since the transfer of assets is as on 30th June, 2012, the profit of ₹ 20,000 must be standing to the credit of A Ltd.

Journal of A Ltd.

2011			*Dr.(₹)*	*Cr. (₹)*
July 1	Business Purchase Account	Dr.	6,37,500	
	To Liquidator of B Ltd.			6,37,500
	(Purchase consideration settled as per agreement dated... for the business of B Ltd.)			
	Land A/c	Dr.	1,00,000	
	Buildings A/c	Dr.	2,50,000	
	Plant A/c	Dr.	3,50,000	
	Inventory A/c	Dr.	86,000	
	Trade receivables A/c	Dr.	25,000	

Bank A/c	Dr.	55,000	
To Provision for Depreciation A/c			15,000
To Profit & Loss Suspense A/c			20,000
To Trade payables A/c			15,000
To Business Purchase A/c			6,37,500
To Liability for Debentures in B Ltd			60,000
To Capital Reserve A/c			1,18,500
(Various assets and liabilities taken over from B Ltd. – profit up to June 30, 2012 being credited to P & L Suspense A/c since it is to be adjusted for interest and additional depreciation due to increase in values of assets)			
Capital Reserve A/c	Dr.	5,000	
To Cash A/c			5,000
(Expenses of Liquidation paid by A Ltd.)			
Liquidator of B Ltd.	Dr.	6,37,500	
To Cash A/c			75,625
To Share Capital A/c			4,49,500
To Securities Premium A/c			1,12,375
(Discharge of the purchase consideration as per agreement)			
Liability for Debentures in B Ltd. A/c	Dr.	60,000	
Discount on issue of debentures A/c	Dr.	2,500	
To 7% Debentures A/c			62,500
(Discharge of debenture holders of B Ltd.)			

Note : (1) Debentures are issued at ₹ 96. Hence the nominal value is $60{,}000 \times \frac{100}{96}$ or ₹ 62,500; ₹ 2,500 is, therefore, debited to the Discount on Issue of Debentures Account.

(2) It is assumed that the reduction in the value of the Inventory as on Jan. 1, 2012 still applies.

Illustration 3

Star and Moon had been carrying on business independently. They agreed to amalgamate and form a new company Neptune Ltd. with an authorised share capital of ₹ 2,00,000 divided into 40,000 equity shares of ₹ 5 each.

On 31st December, 2012, the respective summarized Balance Sheets of Star and Moon were as follows:

	Star	Moon
	₹	₹
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875
	4,81,000	2,66,375
Less: Current Liabilities	(2,98,500)	(90,125)
Representing Capital	1,82,500	1,76,250

Additional Information :

(a) *Revalued figures of Fixed and Current Assets were as follows:*

	Star	Moon
	₹	₹
Fixed Assets	3,55,000	1,95,000
Current Assets	1,49,750	78,875

(b) *The Trade receivables and Trade payables—include ₹ 21,675 owed by Star to Moon.*

The purchase consideration is satisfied by issue of the following shares and debentures:

(i) *30,000 equity shares of Neptune Ltd., to Star and Moon in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows :*

	Star	Moon
2010 Profit	2,24,788	1,36,950
2011 (Loss)/Profit	(1,250)	1,71,050
2012 Profit	1,88,962	1,79,500

(ii) *15% debentures in Neptune Ltd., at par to provide an income equivalent to 8% return on capital employed in their respective business as on 31st December, 2012 after revaluation of assets.*

You are requested to:

(1) *Compute the amount of debentures and shares to be issued to Star and Moon.*

(2) *A Balance Sheet of Neptune Ltd., showing the position immediately after amalgamation.*

Solution

(1) **Computation of Amount of Debentures and Shares to be issued:**

			Star	Moon
			₹	₹
(i)	*Average Net Profit*			
	$\frac{2,24,788-1,250+1,88,962}{3}$	=	1,37,500	
	$\frac{1,36,950+1,71,050+1,79,500}{3}$	=	1,62,500	
(ii)	*Equity Shares Issued*			
	(a) Ratio of distribution			
	Star : Moon			
	1,375 1,625			
	(b) Number			
	Star : 13,750			
	Moon: 16,250			
	30,000			
	(c) Amount			
	13,750 shares of ₹ 5 each	=	68,750	
	16,250 shares of ₹ 5 each	=		81,250
(iii)	*Capital Employed (after revaluation of assets)*			
	Fixed Assets		3,55,000	1,95,000
	Current Assets		1,49,750	78,875
			5,04,750	2,73,875
	Less: Current Liabilities		(2,98,500)	(90,125)
			2,06,250	1,83,750
(iv)	*Debentures Issued*			
	8% Return on capital employed		16,500	14,700
	15% Debentures to be issued to provide equivalent income :			
	Star : $16,500 \times \frac{100}{15}$	=	1,10,000	
	Moon : $14,700 \times \frac{100}{15}$	=		98,000

(2) **Balance Sheet of Neptune Ltd.**

As at 31st December, 2012

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,50,000
(b) Reserves and Surplus	2	32,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	2,08,000
(3) Current Liabilities		
(a) Other current liabilities		3,66,950
Total		7,56,950
II. Assets		
(1) Non-current assets		
(a) Fixed assets		5,50,000
(2) Current assets		
(a) Other current assets		2,06,950
Total		7,56,950

Notes to Accounts

			₹
1	**Share Capital**		
	Authorised		
	40,000 Equity Shares of ₹ 5 each		2,00,000
	Issued and Subscribed		
	30,000 Equity Shares of ₹ 5 each		1,50,000
	(all the above shares are allotted as fully paid-up pursuant to a contract without payments being received in cash)		
2	**Reserve and Surplus**		
	Capital Reserve		32,000
3	**Long-term borrowings**		
	Secured Loans		
	15% Debentures		2,08,000

Working Notes:

			Star ₹	Moon ₹	Total ₹
(1)		*Purchase Consideration*			
		Equity Shares Issued	68,750	81,250	1,50,000
		15% Debentures Issued	1,10,000	98,000	2,08,000
			1,78,750	1,79,250	3,58,000
(2)		*Capital Reserve*			
	(a)	Net Assets taken over			
		Fixed Assets	3,55,000	1,95,000	5,50,000
		Current Assets	1,49,750	57,200*	2,06,950
			5,04,750	2,52,200	7,56,950
		Less : Current Liabilities	(2,76,825**)	(90,125)	(3,66,950)
			2,27,925	1,62,075	3,90,000
	(b)	Purchase Consideration	1,78,750	1,79,250	3,58,000
	(c)	Capital Reserve [(a) - (b)]	49,175		
	(d)	Goodwill [(b) - (a)]		17,175	
	(e)	Capital Reserve [Final Figure(c) - (d)]			32,000

* 78, 875 - 21,675

** 2,98,500 - 21,675

Illustration 4

P and Q have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called PQ Ltd. Following is the summarized Balance Sheet of P and Q as at 31.3.2012:

Liabilities	*P ₹*	*Q ₹*	*Assets*	*P ₹*	*Q ₹*
Capital	*7,75,000*	*8,55,000*	*Plant & machinery*	*4,85,000*	*6,14,000*
Current liabilities	*6,23,500*	*5,57,600*	*Building*	*7,50,000*	*6,40,000*
			Current assets	*1,63,500*	*1,58,600*
	13,98,500	*14,12,600*		*13,98,500*	*14,12,600*

Following are the additional information:

(i) The authorised capital of the new company will be ₹ 25,00,000 divided into 1,00,000 equity shares of ₹ 25 each.

(ii) *Liabilities of P includes ₹ 50,000 due to Q for the purchases made. Q made a profit of 20% on sale to P.*

(iii) *P has goods purchased from Q, cost to him ₹ 10,000. This is included in the Current asset of P as at 31st March, 2012.*

(iv) *The assets of P and Q are to be revalued as under:*

	P ₹	Q ₹
Plant and machinery	*5,25,000*	*6,75,000*
Building	*7,75,000*	*6,48,000*

(v) *The purchase consideration is to be discharged as under:*

(a) *Issue 24,000 equity shares of ₹ 25 each fully paid up in the proportion of their profitability in the preceding 2 years.*

(b) *Profits for the preceding 2 years are given below:*

	P ₹	Q ₹
1st year	*2,62,800*	*2,75,125*
IInd year	*2,12,200*	*2,49,875*
Total	*4,75,000*	*5,25,000*

(c) *Issue 12% preference shares of ₹ 10 each fully paid up at par to provide income equivalent to 8% return on capital employed in the business as on 31.3.2012 after revaluation of assets of P and Q respectively.*

You are required to:

(i) *Compute the amount of equity and preference shares issued to P and Q.*

(ii) *Prepare the Balance Sheet of P & Q Ltd. immediately after amalgamation.*

Solution

(i) **Calculation of amount of equity shares issued to P and Q**

Profits of	P ₹	Q ₹
I year	2,62,800	2,75,125
II year	2,12,200	2,49,875
Total	4,75,000	5,25,000

No. of shares to be issued = 24,000 equity shares in the proportion of the preceding 2 years' profitability

24,000 x 475/1,000	11,400 equity shares	
24,000 x 525/1,000		12,600 equity shares

Calculation of amount of 12% Preference shares issued to P and Q

	P ₹	Q ₹
Capital employed (Refer working note 1)	8,40,000	9,24,000
8% return on capital employed	67,200	73,920
12% Preference shares to be issued $\left[67,200 \times \frac{100}{12}\right]$	₹ 5,60,000	
$\left[73,920 \times \frac{100}{12}\right]$		₹ 6,16,000

Total Purchase Consideration

	P ₹	Q ₹
Equity Shares	2,85,000	3,15,000
12% Preference shares	5,60,000	6,16,000
Total	8,45,000	9,31,000

(ii) **Balance Sheet of PQ Ltd. (after amalgamation)**

Particulars	**Note No.**	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	17,76,000
(2) Current Liabilities		
(c) Other current liabilities (W.N. 3)		11,31,100
Total		29,07,100
II. Assets		
(1) Non-current assets		
(a) Fixed assets	2	
Tangible assets		26,23,000
Intangible assets		14,000
(2) Current assets		
(a) Other current assets (W.N. 2)		2,70,100
Total		29,07,100

Notes to Accounts

			₹
1	**Share Capital**		
	Equity Share Capital		

	Authorised share capital:		
	1,00,000 Equity Share of ₹ 25 each		25,00,000
	Issued and subscribed share capital:		
	24,000 Equity Shares of ₹ 25 each	6,00,000	
	Preference Share Capital		
	1,17,600 12% Preference shares of ₹ 10 each (All of the equity and preference shares have been issued for consideration other than cash)	11,76,000	17,76,000
2	**Fixed Assets**		
	(i) Tangible assets		
	Plant and Machinery	12,00,000	
	Building	14,23,000	26,23,000
	(ii) Intangible assets		
	Goodwill (W.N.1)		14,000

Working Notes:

1. Goodwill

	P ₹	Q ₹
Plant and machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000
Current assets	1,63,500	1,58,600
	14,63,500	14,81,600
Less: Current liabilities	(6,23,500)	(5,57,600)
Net assets taken (capital employed)	8,40,000	9,24,000
Less: Purchase consideration	(8,45,000)	(9,31,000)
Goodwill	5,000	7,000
Total purchased goodwill		12,000
Add: Unrealised profit of ₹ 10,000 @ 20% = ₹ 2,000 is adjusted from current assets and from goodwill (since P & L A/c is not given)		2,000
Total Goodwill		14,000

2. Current Assets

	P ₹	Q ₹
Balances before amalgamation	1,63,500	1,58,600

Less: Liabilities of P due to Q	-	(50,000)
Less: Unrealised Profit on Inventory i.e.₹ 10,000 x 20%	(2,000)	
Total	1,61,500	1,08,600
Grand Total		2,70,100

3. Current Liabilities

	P ₹	Q ₹
Balances before amalgamation	6,23,500	5,57,600
Less: Liabilities of P due to Q	(50,000)	-
Total	5,73,500	5,57,600
Grand Total		11,31,100

Illustration 5

X Ltd. and Y Ltd. were amalgamated on and from 1st April, 2012 and formed a new company Z Ltd. to takeover the business of X Ltd. and Y Ltd. The summarized Balance Sheets of X Ltd. and Y Ltd., as on 31st March, 2012 are as follows:

					(₹ in Crores)
Liabilities	*X Ltd.*	*Y Ltd.*	*Assets*	*X Ltd.*	*Y Ltd.*
Share Capital:			*Land and Buildings*	*38*	*25*
Equity share of ₹ 10 each	*50*	*45*	*Plant and Machinery*	*24*	*17*
10% Preference shares of ₹ 100 each	*20*	*14*	*Investments*	*10*	*6*
Revaluation Reserve	*10*	*6*	*Inventory*	*22*	*15*
General Reserve	*12*	*8*			
Investment Allowance Reserve	*5*	*4*	*Trade Receivable*	*30*	*24*
			Cash at Bank	*16*	*13*
Profit & Loss Account	*8*	*6*			
15% Debentures of ₹ 100 each (Secured)	*4*	*5*			
Trade payable	*31*	*12*			
	140	*100*		*140*	*100*

Additional Information:

(1) Z Ltd. will issue 6 equity shares for 10 equity shares of X Ltd. and 2 equity shares for 5 equity shares of B Ltd. The shares are issued @ ₹ 30 each having a face value of ₹ 10 per share.

(2) Preference shareholders of two companies are issued equivalent number of 15% preference shares of Z Ltd. at a price of ₹ 120 per share (face value ₹ 100).

(3) 15% Debentureholders of X Ltd. and Y Ltd. are discharged by Z Ltd. issuing such number of its 18% Debentures of ₹ 100 each so as to maintain the same amount of interest.

(4) Investment allowance reserve is to be maintained for 4 more years.

Prepare the Balance Sheet of Z Ltd. after amalgamation. The amalgamation took place in the nature of purchase.

Solution

Balance Sheet of Z Ltd. as at 1st April, 2012

(₹ in crores)

Particulars	**Note No**	
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	82.00
(b) Reserves and Surplus	2	116.50
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7.50
(3) Current Liabilities		
(a) Trade payables		43
Total		249.00
II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	104.00
(b) Non-current investments		16.00
(c) Other non-current assets	6	9.00
(2) Current assets		
(a) Current investments		
(b) Inventories		37.00
(c) Trade receivables		54.00
(d) Cash and cash equivalents	5	29.00
Total		249.00

Notes to Accounts *(₹ in crores)*

1	**Share Capital**		
	Equity Share Capital		
	4,80,00,000 Equity shares of ₹ 10 each	48.00	

	Preference Share Capital		
	34,00,000 15% Preference Shares of ₹ 100 each	34.00	82.00
	(all the above shares are allotted as fully paid up pursuant to contracts without payment being received in cash)		
2	**Reserve and Surplus**		
	Security Premium (60 + 36 + 4 + 2.8)	102.80	
	Capital Reserve	4.70	
	Investment Allowance Reserve	9.00	116.50
3	**Long Term Borrowings**		
	Secured Loans		
	18% of Debentures (₹ 100 each)	7.50	7.50
4	**Fixed assets**		
	Tangible assets		
	Land and Buildings	63.00	
	Plant and Machinery	41.00	104.00
5	**Cash and cash equivalents**		
	Cash At Bank		29.00
6	**Other non-current assets**		
	Amalgamation Adjustment Account		9.00

Note: Since Investment Allowance Reserve is to be maintained for 4 years, it is carried forward by a corresponding debit to Amalgamation Adjustment Account in accordance with AS-14.

Working Notes:

1.	**Calculation of Net assets taken over**		*(₹ In crores)*	
	Particulars		X Ltd.	Y Ltd.
	Assets taken over:			
	Land and Buildings		38	25
	Plant and Machinery		24	17
	Investments		10	6
	Inventory		22	15
	Trade Receivable		30	24
	Cash at Bank		16	13
		(i)	140	100
	Liabilities taken over:			
	Debentures		3.33	4.17

Trade payable		31.00	12.00
	(ii)	34.33	16.17
Net assets taken over	(i) – (ii)	105.67	83.83

2. Calculation of value of Debentures to be issued in Z Ltd.

X Ltd.

Existing Debenture interest @ 15% = ₹ 400 lakhs x 15/100 = ₹ 60 lakhs

Debentures to be issued in Z Ltd. @ 18% to maintain the same amount of interest

= ₹ 60 lakhs x 100/18 = ₹ 333.33 lakhs or ₹ 3.33 crores

Y Ltd.

Existing Debenture interest @15% = ₹ 500 lakhs x 15/100 = ₹ 75 lakhs

Debentures to be issued in Z Ltd. @ 18% to maintain the same amount of interest

= ₹ 75 x 100/18 = ₹ 416.67 lakhs or ₹ 4.17 crores

3. Computation of Purchase Consideration: *(₹ In crores)*

		X Ltd.	*Y Ltd.*
1.	Equity Shareholders		
	$\frac{₹\ 50\,\text{crores}}{₹\ 10}\times\frac{6}{10}\times ₹\ 30$	90	
	$\frac{₹\ 45\,\text{crores}}{₹\ 10}\times\frac{2}{5}\times ₹\ 30$		54
2.	Preference Shareholders		
	$\frac{₹\ 20\,\text{crores}}{₹\ 100}\times ₹\ 120$	24	
	$\frac{₹\ 14\,\text{crores}}{₹\ 100}\times ₹\ 120$	—	16.8
	Total Purchase consideration	114	70.8

4. Calculation of Goodwill/Capital Reserve (₹ in crores)

Particulars	*X Ltd.*	*Y Ltd.*
Net Assets takeover	105.67	83.83
Less: Purchase Consideration	(114.00)	(70.80)
Goodwill	8.33	----
Capital Reserve	---	13.03

Note: Goodwill arising from amalgamation shall be adjusted against Capital Reserve arising from amalgamation, and only balance of ₹ 4.70 crores is to be shown in the Balance Sheet of Z Ltd as capital reserve.

Illustration 6

The summarized Balance Sheet of A Limited and B Limited as at 31st March, 2012 are as follows:

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Equity share of ₹ 10 each	20,00,000	12,00,000	Sundry assets	30,00,000	18,00,000
General reserve	4,00,000	2,20,000			
Trade payables	6,00,000	3,80,000			
	30,00,000	18,00,000		30,00,000	18,00,000

Sundry assets of B Ltd. includes long term investment of ₹ 4,00,000, the market value of which is now ₹ 4,80,000. A Ltd. absorbed B Ltd. on the basis of intrinsic value of the shares. The purchase consideration is to be discharged in fully paid-up equity shares. A sum of ₹ 1,00,000 is owed by A Ltd. to B Ltd., also included in the Inventory of A Ltd. is ₹ 1,20,000 goods supplied by B Ltd. at cost plus 20%.

Give Journal entries in the books of both the companies, if entries are made at intrinsic value. Also prepare Balance Sheet of A Ltd. after absorption.

Answer

In the Books of B Ltd.

Journal Entries

			Dr. (₹)	Cr. (₹)
(i)	Realisation A/c	Dr.	18,00,000	
	To Sundry assets A/c			18,00,000
	(Being assets transferred to realization account on sale of business to A Ltd.)			
(ii)	Trade payables A/c	Dr.	3,80,000	
	To Realisation A/c			3,80,000
	(Being trade payables transferred to realization account on sale of business to A Ltd.)			
(iii)	Equity share capital A/c	Dr.	12,00,000	
	General reserve A/c	Dr.	2,20,000	
	To Equity shareholders A/c			14,20,000
	(Being transfer of share capital and general reserve to shareholders account)			
(iv)	A Ltd.	Dr.	15,00,000	
	To Realisation A/c			15,00,000
	(Being purchase consideration due – W.N. 2)			
(v)	Equity shares in A Ltd.	Dr.	15,00,000	

	To A Ltd.			15,00,000
	(Being purchase consideration received by A Ltd.)			
(vi)	Realisation A/c	Dr.	80,000	
	To Equity shareholders A/c			80,000
	(Being profit on realization transferred to shareholders account)			
(vii)	Equity shareholders A/c	Dr.	15,00,000	
	To Equity shares in A Ltd. A/c			15,00,000
	(Being 1,25,000 shares for ₹ 12 each distributed to equity shareholders of B Ltd.)			

Journal Entries In the Books of A Ltd.

			Dr. (₹)	*Cr. (₹)*
(i)	Business purchase A/c	Dr.	15,00,000	
	To Liquidators of B Ltd. A/c			15,00,000
	(Being amount payable to B Ltd. – W.N. 2)			
(ii)	Sundry assets A/c	Dr.	18,80,000	
	To Trade payables A/c			3,80,000
	To Business purchase A/c			15,00,000
	(Being assets & liabilities taken over and purchase consideration due)			
(iii)	Liquidators of B Ltd. A/c	Dr.	15,00,000	
	To Equity share capital A/c			12,50,000
	To Securities premium A/c			2,50,000
	(Being shares allotted in full payment of purchase consideration)			
(iv)	Trade payables A/c	Dr.	1,00,000	
	To Trade receivables (of B Ltd.) A/c			1,00,000
	(Being cancellation of mutual liability of Trade receivables &Trade payables of ₹ 1,00,000)			
(v)	General reserve A/c	Dr.	20,000*	
	To Inventory A/c			20,000
	(Being elimination of unrealized profit on unsold Inventory of ₹ 1,20,000, bought from B Ltd.)			

*Unrealized profit = ₹ 1,20,000 × 20/120 = ₹ 20,000.

Balance Sheet of A Ltd.
as at 31st March, 2012

Particulars	*Note No*	*₹*
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	32,50,000
(b) Reserves and Surplus	2	6,30,000
(2) Non-Current Liabilities		
(3) Current Liabilities		
(a) Trade payables	3	8,80,000
Total		47,60,000
II. Assets		
(1) Non-current assets		
Non-current investment		4,80,000
(2) Current assets	4	42,80,000
Total		47,60,000

Notes to Accounts

1	**Share Capital**		
	3,25,000 Equity shares of ₹ 10 each		32,50,000
	(of the above, 1,25,000 equity shares of ₹ 10 each are issued for consideration other than cash)		
2	**Reserve and Surplus**		
	Securities premium	2,50,000	
	General reserve	3,80,000	6,30,000
3	**Trade payables**		
	(6,00,000 + 3,80,000- 1,00,000)		8,80,000
4	**Current assets**		
	Sundry assets		
	(30,00,000 + 14,00,000 – 1,00,000 – 20,000)		42,80,000

Working Notes:

1. **Calculation of Intrinsic Value of shares of 'A' Ltd.**

	₹
Sundry assets of A Ltd.	30,00,000

Less: Trade payables	(6,00,000)
Net assets	24,00,000
Number of equity shares	2,00,000 shares
Intrinsic value per equity share = $\frac{₹\ 24,00,000}{2,00,000\ \text{shares}}$	₹ 12 per share

2. Calculation of Purchase Consideration ₹

Sundry assets of B Ltd. (other than investment)	14,00,000
Add: Investments at market value	4,80,000
	18,80,000
Less: Trade payables	(3,80,000)
Net assets	15,00,000
	Shares
Total number of equity shares to be issued by A Ltd. @₹ 12 per share (₹ 15,00,000 / ₹ 12)	1,25,000
	₹
Equity share capital (1,25,000 shares × ₹ 10)	12,50,000
Securities premium (1,25,000 shares × ₹ 2)	2,50,000
Purchase consideration	15,00,000

Illustration 7

The following are the summarized Balance Sheets of A Ltd. and B Ltd. as on 31st December, 2011:

Liabilities	*A Ltd.* ₹	*B Ltd.* ₹	*Assets*	*A Ltd.* ₹	*B Ltd.* ₹
Share Capital			*Fixed Assets*	*7,00,000*	*2,50,000*
Equity Shares of ₹ 10 each	*6,00,000*	*3,00,000*	*Current Assets: Inventory*	*2,40,000*	*3,20,000*
10% Pref. Shares of ₹100 each	*2,00,000*	*1,00,000*	*Trade Receivable*	*5,00,000*	*2,90,000*
Reserves and Surplus	*3,00,000*	*2,00,000*	*Cash at Bank*	*1,10,000*	*40,000*
Secured Loans:					
12% Debentures	*2,00,000*	*1,50,000*			
Current Liabilities:					
Trade Payable	*2,50,000*	*1,50,000*			
	15,50,000	*9,00,000*		*15,50,000*	*9,00,000*

Details of Trade receivables and trade payables are as under:

Trade payables	*A Ltd.*	*B Ltd.*
Sundry Creditors	*2,20,000*	*1,25,000*
Bills Payable	*30,000*	*25,000*
	2,50,000	*1,50,000*
Trade receivables		
Debtors	*3,60,000*	*1,90,000*
Bills Receivable	*1,40,000*	*1,00,000*
	5,00,000	*2,90,000*

Fixed Assets of both the companies are to be revalued at 15% above book value. Inventory in Trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, A Ltd. will absorb B Ltd. on the following terms:

(i) 8 Equity Shares of ₹ 10 each will be issued by A Ltd. at par against 6 shares of B Ltd.

(ii) 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in A Ltd.

(iii) 12% Debentureholders of B Ltd. are to be paid at 8% premium by 12% Debentures in A Ltd. issued at a discount of 10%.

(iv) ₹ 30,000 is to be paid by A Ltd. to B Ltd. for Liquidation expenses. Sundry Creditors of B Ltd. include ₹ 10,000 due to A Ltd.

Prepare:

(a) Absorption entries in the books of A Ltd.

(b) Statement of consideration payable by A Ltd.

Solution

(a) Absorption Entries in the Books of A Ltd.

		Dr. ₹	Cr. ₹
Fixed Assets	Dr.	1,05,000	
To Revaluation Reserve			1,05,000
(Revaluation of fixed assets at 15% above book value)			
Reserve and Surplus	Dr.	60,000	
To Equity Dividend			60,000
(Declaration of equity dividend @ 10%)			

Equity Dividend	Dr.	60,000	
To Bank Account			60,000
(Payment of equity dividend)			
Business Purchase Account	Dr.	5,20,000	
To Liquidator of B Ltd.			5,20,000
(Consideration payable for the business taken over from B Ltd. inclusive of liquidation expenses of ₹ 30,000)			
Fixed Assets (115% of ₹ 2,50,000)	Dr.	2,87,500	
Inventory (95% of ₹ 3,20,000)	Dr.	3,04,000	
Debtors	Dr.	1,90,000	
Bills Receivable	Dr.	1,00,000	
Cash at Bank	Dr.	10,000	
(₹ 40,000 – ₹ 30,000 dividend paid)			
To Provision for Bad Debts (5% of ₹ 1,90,000)			9,500
To Sundry Creditors			1,25,000
To 12% Debentures in B Ltd.			1,62,000
To Bills Payable			25,000
To Business Purchase Account			5,20,000
To Capital Reserve (Balancing figure)			50,000
(Incorporation of various assets and liabilities taken over from B Ltd. at agreed values, profit being credited to capital reserve)			
Liquidator of B Ltd.	Dr.	5,20,000	
To Equity Share Capital			4,00,000
To 10% Preference Share Capital			90,000
To Bank A/c			30,000
(Discharge of consideration for B Ltd.'s business and liquidation expenses of ₹ 30,000)			
12% Debentures in B Ltd. (₹ 1,50,000 × 108%)	Dr.	1,62,000	
Discount on Issue of Debentures	Dr.	18,000	
To 12% Debentures			1,80,000
(Allotment of 12% Debentures to debenture holders at a discount of 10% to discharge the liability on B Ltd. debentures)			

Sundry Creditors	Dr.	10,000	
To Sundry Debtors			10,000
(Cancellation of mutual owing)			

(b) Statement of Consideration payable by A Ltd.

Shares to be allotted 30,000/6 × 8 = 40,000

i.e. A Ltd. will issue 40,000 shares of ₹ 10 each= ₹ 4,00,000 (i)

For 10% preference shares, to be paid at 10% discount

₹ $\frac{1,00,000 \times 90}{100}$ ₹ 90,000 (ii)

Consideration amount [(i) + (ii)] ₹ 4,90,000

Note: It has been assumed that dividend on equity shares have been paid by both the companies.

Illustration 8

AX Ltd. and BX Ltd. amalgamated on and from 1st January, 2013. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-2012

Equity and Liabilities	*AX Ltd. ₹ '000*	*BX Ltd. ₹ '000*	*Assets*	*AX Ltd. ₹ '000*	*BX Ltd. ₹ '000*
Share Capital			*Sundry Fixed*		
Equity Shares of			*Assets*	*85,00*	*75,00*
₹ 10 each	*60,00*	*70,00*	*Investment*	*10,50*	*5,50*
General Reserve	*15,00*	*20,00*	*Inventory*	*12,50*	*27,50*
P & L A/c	*10,00*	*5,00*	*Trade receivables*	*18,00*	*40,00*
Investment Allowance			*Cash & Bank*	*4,50*	*4,00*
Reserve	*5,00*	*1,00*			
Export Profit Reserve	*50*	*1,00*			
12% Debentures	*30,00*	*40,00*			
Trade payables	*10,00*	*15,00*			
	130,50	*152,00*		*130,50*	*152,00*

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

You are required to prepare (i) Note showing purchase consideration and discharge thereof,

(ii) Journal entries in the books of ABX Ltd. For taking over both companies, (iii) Balance Sheet of ABX Ltd. as on 1st January, 2013 assuming the amalgamation is in the nature of purchase.

Solution

(i) Calculation of Purchase Consideration

		AX Ltd. ₹ '000		*BX Ltd.* ₹ '000
Assets taken over:				
Sundry fixed assets		85,00		75,00
Investments		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Bank		4,50		4,00
Gross Assets		130,50		152,00
Less : Sundry Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Purchase Consideration		90,50		97,00

. **Discharge of Purchase consideration:**

	AX Ltd. ₹ '000	*BX Ltd.* ₹ '000
9,05,000 Equity Shares of ₹ 10 each	90,50	
9,70,000 Equity Shares of ₹ 10 each		97,00

(ii) Journal entries in books of ABX Ltd.

		₹'000	₹'000
Business Purchase A/c	Dr.	18,750	
To Liquidator of AX Ltd.			90,50
To Liquidator of BX Ltd.			97,00
(Being Business of AX Ltd. & BX Ltd. purchased)			
Sundry fixed assets	Dr.	85,00	
Investment A/c	Dr.	10,50	
Inventory	Dr.	12,50	
Trade receivables	Dr.	18,00	
Cash and Bank	Dr.	4,50	

To 12% Debentures			30,00
To Trade payables			10,00
To Business Purchase A/c			90,50
(Being the purchase consideration of AX Ltd. accounted for)			
Sundry fixed assets	Dr.	75,00	
Investment A/c	Dr.	5,50	
Inventory	Dr.	27,50	
Trade receivables	Dr.	40,00	
Cash and Bank	Dr.	4,00	
To 12% Debentures			40,00
To Trade payables			15,00
To Business Purchase A/c			97,00
(Being the purchase consideration of BX Ltd. accounted for)			
Liquidator of AX Ltd.	Dr.	90,50	
To Equity share capital A/c			90,50
(Being shares issued to Liquidator of AX Ltd.)			
Liquidator of BX Ltd. A/c	Dr.	97,00	
To Equity share capital A/c			97,00
(Being shares issued to Liquidator of BX Ltd.)			

(iii) Balance Sheet of ABX Ltd. as on 1.1.2013

Particulars	*Note No.*	*(₹ 000)*
I. **Equity and Liabilities**		
(1) **Shareholder's Funds**		
(a) Share Capital	1	187,50
(b) Reserves and Surplus	2	7,50
(2) **Non-Current Liabilities**		
Long-term borrowings	3	70,00
(3) **Current Liabilities**		
(a) Trade payables (10,00 + 15,00)		25,00
Total		290,00
II. **Assets**		
(1) **Non-current assets**		
(a) Fixed assets		
Tangible assets (85,00 + 75,00)		160,00
(b) Non-current Investments (10,50+ 5,50)		16,00

	(c)	Other non-current asset	4	7,50
(2)	**Current assets**			
	(a)	Inventories (12,50 + 27,50)		40,00
	(b)	Trade Receivables (18,00 + 40,00)		58,00
	(c)	Cash & Cash equivalents (4,50 + 4,00)		8,50
		Total		290,00

Notes to Accounts

		(₹ 000)	(₹ 000)
1.	**Share Capital**		
	18,75,000 Equity Shares of ₹ 10 each		187,500
2.	**Reserves and surplus**		
	Investment Allowance Reserve	6,00	
	Export Profit Reserve	1,50	7,50
3.	**Long Term Borrowings**		
	12% Debentures (Assumed that new debentures were issued in exchange of the old series)		70,00
4.	**Other non-current assets**		
	Amalgmation Adjustment Account		7,50

Notes :

(1) Shares are issued by ABX Ltd. on the basis of net assets acquired of AX Ltd. and BX Ltd. Hence, there is no goodwill.

(2) The statutory reserves of AX Ltd. and BX Ltd. are shown in the balance sheet of ABX Ltd. with a corresponding debit in Amalgamation Adjustment Account.

Internal Reconstruction of a Company

Illustration 9

Following is the Summary Balance Sheet of ABC Ltd. as at 31st March, 2012:

Liabilities	*₹*	*Assets*	*₹*
Share capital:		*Plant and machinery*	*9,00,000*
2,00,000 Equity shares of		*Furniture and fixtures*	*2,50,000*
₹ 10 each fully paid up	*20,00,000*	*Patents and copyrights*	*70,000*
6,000 8% Preference shares of ₹ 100 each	*6,00,000*	*Investments (at cost) (Market value ₹ 55,000)*	*68,000*

9% Debentures	*12,00,000*	*Inventory*	*14,00,000*
Bank overdraft	*1,50,000*	*Trade receivables*	*14,39,000*
Trade payables	*5,92,000*	*Cash and bank balance*	*10,000*
		Profit and Loss A/c	*4,05,000*
	45,42,000		*45,42,000*

The following scheme of reconstruction was finalised:

(i) *Preference shareholders would give up 30% of their capital in exchange for allotment of 11% Debentures to them.*

(ii) *Debentureholders having charge on plant and machinery would accept plant and machinery in full settlement of their dues.*

(iii) *Inventory equal to ₹ 5,00,000 in book value will be taken over by trade payables in full settlement of their dues.*

(iv) *Investment value to be reduced to market price.*

(v) *The company would issue 11% Debentures for ₹ 3,00,000 and augment its working capital requirement after settlement of bank overdraft.*

Pass necessary Journal Entries in the books of the company. Prepare Capital Reduction account and Balance Sheet of the company after internal reconstruction.

Solution

In the Books of ABC Ltd.
Journal Entries

Particulars		₹	₹
8% Preference share capital A/c	Dr.	6,00,000	
To Preference shareholders A/c			4,20,000
To Capital reduction A/c			1,80,000
[Being 30% reduction in liability of preference share capital]			
Preference shareholders A/c	Dr.	4,20,000	
To 11% Debentures A/c			4,20,000
[Being the issue of debentures to preference shareholders]			
9% Debentures A/c	Dr.	12,00,000	
To Debenture holders A/c			12,00,000
[Being transfer of 9% debentures to debenture holders A/c]			
Debenture holders A/c	Dr.	12,00,000	
To Plant & machinery A/c			9,00,000

To Capital reduction A/c			3,00,000
[Settlement of debenture holders by allotment of plant & machinery]			
Trade payables A/c	Dr.	5,92,000	
To Inventory A/c			5,00,000
To Capital reduction A/c			92,000
[Being settlement of creditors by giving Inventorys]			
Bank A/c	Dr.	3,00,000	
To 11% Debentures A/c			3,00,000
[Being fresh issue of debentures]			
Bank overdraft A/c	Dr.	1,50,000	
To Bank A/c			1,50,000
[Being settlement of bank overdraft]			
Capital reduction A/c	Dr.	5,72,000	
To Investment A/c			13,000
To Profit and loss A/c			4,05,000
To Capital reserve A/c			1,54,000
[Being decrease in investment and profit and loss account (Dr. bal.); and balance of capital reduction account transferred to capital reserve]			

Capital Reduction Account

	₹		₹
To Investments A/c	13,000	By Preference share capital A/c	1,80,000
To Profit and loss A/c	4,05,000	By 9% Debenture holders A/c	3,00,000
To Capital reserve A/c	1,54,000	By Trade payables A/c	92,000
	5,72,000		5,72,000

Balance Sheet of ABC Ltd. (And Reduced)
As on 31st March 2012

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	20,00,000
(b) Reserves and Surplus	2	1,54,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	7,20,000
Total		28,74,000

II. Assets		
(1) Non-current assets		
(a) Fixed assets	4	
Tangible assets		2,50,000
Intangible assets		70,000
(b) Non-current investments	5	55,000
(2) Current assets		
(a) Current investments		
(b) Inventories (₹ 14,00,000 – ₹ 5,00,000)		9,00,000
(c) Trade receivables		14,39,000
(d) Cash and cash equivalents		
Cash at Bank (W. N.)		1,60,000
Total		28,74,000

Notes to Accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹ 10 each fully paid-up		20,00,000
2.	**Reserve and Surplus**		
	Capital Reserve		1,54,000
3.	**Long Term Borrowings**		
	11% Debentures (₹ 4,20,000 + ₹ 3,00,000)		7,20,000
4.	**Fixed Assets**		
	(i) Tangible assets		
	Plant & machinery	9,00,000	
	Less: Adjustment on scheme of reconstruction dated…	9,00,000	-
	Furniture & fixtures		2,50,000
	(ii) Intangible assets		
	Patents & copyrights		70,000
			3,20,000
5.	**Non Current Investments**		
	Investments (₹ 68,000 – ₹ 13,000)		55,000

Working Note:

Cash at bank = Opening balance + 11% Debentures issued – Bank overdraft paid
= ₹ 10,000 + ₹ 3,00,000 – ₹ 1,50,000 = ₹ 1,60,000

Illustration 10

S.P. Construction Co. finds itself in financial difficulty. The following is the summarized balance sheet on 31st December 2012:

Liabilities	₹	Assets	₹
Share capital		Land	1,56,000
20,000 Equity Shares of		Building (net)	27,246
₹ 10 each fully paid	2,00,000	Equipment	10,754
5% Cum. Pref. Shares of		Goodwill	60,000
₹ 10 each fully paid	70,000	Investments (Quoted) in shares	27,000
8% Debentures	80,000	Inventory	1,20,247
Loan from Directors	16,000	Trade receivables	70,692
Trade payables	96,247	Profit & Loss Account	39,821
Bank Overdrafts	36,713		
Interest Payable on Debentures	12,800		
	5,11,760		5,11,760

The authorised capital of the company is 20,000 Equity Shares of ₹ 10 each and 10,000 5% Cum. Preference Shares of ₹ 10 each.

During a meeting of shareholders and directors, it was decided to carry out a scheme of internal reconstruction. The following scheme has been agreed :

(1) The equity shareholders are to accept reduction of ₹ 7.50 per share. And each equity share is to be redesignated as a share of ₹ 2.50 each.

(2) The equity shareholders are to subscribe for a new share on the basis of 1 for 1 at a price of ₹ 3 per share.

(3) The existing 7,000 Preference Shares are to be exchanged for a new issue of 3,500 8% Cumulative Preference Shares of ₹ 10 each and 14,000 Equity Shares of ₹ 2.50 each.

(4) The Debenture holders are to accept 2,000 Equity Shares of ₹ 2.50 each in lieu of interest payable.

The interest rate is to be increased to 9 ½%. Further ₹ 9,000 of this 9½% Debentures are to be issued and taken up by the existing holders at ₹ 90 for ₹ 100.

(5) ₹ 6,000 of directors' loan is to be credited. The balance is to be settled by issue of 1,000 Equity Shares of ₹ 2.50 each.

(6) Goodwill and the profit and loss account balance are to be written off.

(7) The investment in shares is to be sold at current market value of ₹ 60,000.

(8) The bank overdraft is to be repaid.

(9) ₹ 46,000 is to be paid to trade payables now and balance at quarterly intervals.

(10) 10% of the trade receivables are to be written off.

(11) The remaining assets were professionally valued and should be included in the books of account as follows :

	₹
Land	*90,000*
Building	*80,000*
Equipment	*10,000*
Inventory	*50,000*

(12) It is expected that due to changed condition and new management operating profit will be earned at the rate of ₹ 50,000 p.a. after depreciation but before interest and tax.

Due to losses brought forward it is unlikely that any tax liability will arise until 2014.

You are required to show the necessary journal entries to affect the reconstruction scheme; prepare the balance sheet of the company immediately after the reconstruction.

Solution

S.P. Construction Co. Ltd.

		Dr. ₹	Cr. ₹
Equity Share Capital (₹ 10) A/c	Dr.	2,00,000	
To Capital Reduction A/c			1,50,000
To Equity Share Capital (₹ 2.50) A/c			50,000
(Equity shareholders rights of ₹ 10 shares reduced to a share of ₹ 2.50 vide Board's Resolution dated..., the amount of sacrifice credited to Capital Reduction Account)			
Bank A/c	Dr.	60,000	
To Equity Share Capital A/c			50,000
To Securities Premium A/c			10,000
(20,000 Equity shares issued for cash at premium of Re. 0.50 per share vide Board's Resolution dated...)			
5% Preference share capital A/c	Dr.	70,000	
To 8% Pref. Share Capital A/c			35,000
To Equity Share Capital A/c			35,000
(5% Preference share capital converted into 3,500 8% preference shares of ₹ 10 each and 14,000 Equity shares of ₹ 2.50 each vide Board's Resolution dated...)			
Interest Payable on Debentures A/c	Dr.	12,800	

To Equity Share Capital A/c			5,000
To Capital Reduction A/c			7,800
(2,000 Equity shares of ₹ 2.50 each issued in full and final settlement of interest payable, balance credited to Capital Reduction Account vide Board's Resolution dated.....)			
8% Debentures A/c	Dr.	80,000	
To 9 ½% Debentures A/c			80,000
(8% Debentures converted into 9 ½% Debentures vide Board's Resolution dated.....)			
Bank A/c	Dr.	8,100	
Capital Reduction A/c	Dr.	900	
To 9 ½% Debentures A/c			9,000
(₹ 9,000 Debentures issued at a discount of 10% for cash vide Board's Resolution dated.....)			
Loan from Directors A/c	Dr.	16,000	
To Capital Reduction A/c			6,000
To Equity Share Capital A/c			2,500
To Securities Premium A/c			7,500
(₹ 6,000 of directors' loan credited to Capital Reduction A/c, 1,000 Equity Shares of ₹ 2.50 each issued in settlement of the balance due. ₹ 7,500 credited to share premium A/c vide Board's Resolution dated...)			
Bank A/c	Dr.	60,000	
To Investment A/c			27,000
To Capital Reduction A/c			33,000
(Investment sold for ₹ 60,000, profit on sale credited to capital reduction A/c)			
Bank Overdraft (loan) A/c	Dr.	36,713	
Trade payables A/c	Dr.	46,000	
To Bank A/c			82,713
(Payment of Bank overdraft ₹ 36,713 and ₹ 46,000 paid to Trade payables)			
Building A/c	Dr.	52,754	
To Capital Reduction A/c			52,754
(Appreciation in the value of the building under the scheme of reconstruction dated.....)			
Capital Reduction A/c	Dr.	2,43,891	
To Goodwill			60,000

To Profit & Loss A/c		39,821
To Land		66,000
To Equipment		754
To Inventory		70,247
To Trade receivables		7,069
(Amounts written off on various assets A/c and the amount of goodwill and debit balance of profit and loss account written off under scheme of reconstruction dated...)		

Working Note :

Capital Reduction Account

	₹		₹
To Goodwill	60,000	By Equity Share Capital A/c	1,50,000
To Profit & Loss A/c	39,821	By Debenture Interest	7,800
To Trade receivables	7,069	By Loan from Directors A/c	6,000
To Land	66,000	By Investment A/c	33,000
To Equipment	754	By Building	52,754
To Inventory	70,247		
To Debentures (Discount)	900		
To Capital Reserve	4,763		
	2,49,554		2,49,554

Balance Sheet of S.P. Construction Co. Ltd. (And reduced) as on ......

Particulars	Note No	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,77,500
(b) Reserves and Surplus	2	22,263
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	89,000
(3) Current Liabilities		
(a) Trade payables		50,247
Total		3,39,010

II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	4	1,80,000
(b) Non-current investments	5	-
(2) Current assets		
(a) Inventories		50,000
(b) Trade receivables (₹ 7069 written off)		63,623
(c) Cash and cash equivalents	6	45,387
Total		3,39,010

Notes to Accounts

			₹
1.	**Share Capital**		
	Equity Share Capital		
	57,000 Equity shares of ₹ 2.50 each fully paid (17,000 shares issued on conversion and settlement claims against the company)		1,42,500
	Preference Share Capital		
	8% Cumulative Preference share capital		35,000
			1,77,500
2.	**Reserve and Surplus**		
	Securities Premium		17,500
	Capital Reserve		4,763
			22,263
3.	**Long-term borrowings**		
	Secured Loans		
	9½% Debentures		89,000
4.	**Fixed Assets**		
	(i) Tangible assets		
	Land	1,56,000	
	Less: written off under the scheme of reconstruction	(66,000)	90,000
	Building	27,246	
	Add: Appreciation under the scheme of reconstruction	52,754	80,000
	Equipment	10,754	

	Less: written off under the scheme of reconstruction	(754)	10,000
			1,80,000
	(ii) Intangible assets		
	Goodwill	60,000	
	Less: written off under the scheme of reconstruction	(60,000)	
5.	**Non-current investments**		
	Investments	27,000	
	Less: Sold during the year	(27,000)	
6.	**Cash and cash equivalents**		
	Cash at Bank		45,387

Illustration 11

The Summarised Balance Sheet of Revise Limited as at 31st March, 2012 was as follows :

Liabilities	*₹*	*Assets*	*₹*
Authorised and subscribed capital:		*Fixed Assets :*	
10,000 Equity shares of		*Machineries*	*1,00,000*
₹ 100 each fully paid	*10,00,000*	*Current assets :*	
Unsecured Loans :		*Inventory*	*3,20,000*
12% Debentures	*2,00,000*	*Trade receivables*	*2,70,000*
Accrued interest	*24,000*	*Bank*	*30,000*
Current liabilities		*Profit and loss account*	
Trade payables	*72,000*		
Provision for income tax	*24,000*		*6,00,000*
	13,20,000		*13,20,000*

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

(a) *Each share is sub-divided into ten fully paid up equity shares of ₹ 10 each.*

(b) *After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and trade payables as necessary.*

(c) *Out of shares surrendered, 10,000 shares of ₹ 10 each shall be converted into 12% preference shares of ₹ 10 each, fully paid up.*

(d) *The claims of the debenture-holders shall be reduced by 75 per cent. In consideration of the reduction, the debenture holders shall receive preference shares of ₹ 1,00,000 which are converted out of shares surrendered.*

(e) Trade payables claim shall be reduced to 50 per cent, it is to be settled by the issue of equity shares of ₹ 10 each out of shares surrendered.

(f) Balance of profit and loss account to be written off.

(g) The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant Balance Sheet.

Solution

		Dr. ₹	Cr. ₹
Equity Share Capital (₹ 100) A/c	Dr.	10,00,000	
To Share Surrender A/c			5,00,000
To Equity Share Capital (₹ 10) A/c			5,00,000
(Subdivision of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such subdivided shares as per capital reduction scheme)			
12% Debentures A/c	Dr.	1,50,000	
Accrued Interest A/c	Dr.	18,000	
To Reconstruction A/c			1,68,000
(Transferred 75% of the claims of the debentureholders to reconstruction account in consideration of which 12% preference shares are being issued out of share surrender account as per capital reduction scheme)			
Trade payables A/c	Dr.	72,000	
To Reconstruction A/c			72,000
(Transferred claims of the trade payables to reconstruction account, 50% of which is being clear reduction and equity shares are being issued in consideration of the balance)			
Share Surrender A/c	Dr.	5,00,000	
To 12% Preference Share Capital A/c			1,00,000
To Equity Share Capital A/c			36,000
To Reconstruction A/c			3,64,000
(Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as a per scheme and the balance in share surrender account is being transferred to reconstruction account)			

Reconstruction A/c	Dr.	6,04,000	
To Profit and Loss A/c			6,00,000
To Capital Reserve A/c			4,000
(Adjusted debit balance of profit and loss account against the reconstruction account and the balance in the latter is being transferred to capital reserve)			

Balance Sheet of Revise Limited (and reduced) as on...

Particulars	Note No.	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,36,000
(b) Reserves and Surplus	2	4,000
(2) Non-Current Liabilities		
(a) Long-term borrowings	3	50,000
(3) Current Liabilities		
(a) Other current liabilities	4	6,000
(b) Short-term provisions	5	24,000
Total		7,20,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		
(i) Tangible assets	6	1,00,000
(2) Current assets		
(a) Current investments		
(b) Inventories		3,20,000
(c) Trade receivables		2,70,000
(d) Cash and cash equivalents		30,000
Total		7,20,000

Notes to Accounts

		₹
1.	**Share Capital**	
	Equity Share Capital	
	Issued Capital : 53,600 Equity Shares of ₹ 10 each	5,36,000
	Preference Share Capital	

	Preference Shares (Of the above shares all are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares without payment being received in cash)	1,00,000
		6,36,000
2.	**Reserve and Surplus**	
	Capital Reserve	4,000
3.	**Long-term borrowings**	
	Unsecured Loans	
	12% Debentures	50,000
4.	**Other current liabilities**	
	Accrued interest	6,000
5.	**Short-term provisions**	
	Provision for Income-tax	24,000
6.	**Tangible assets**	
	Machineries	1,00,000

Illustration 12

The shareholders of Maitri Ltd. decided on a corporate restructuring exercise necessitated because of economic recession. From the given summarised balance sheet as on 31-3-2012 and the information supplied, you are required to prepare (i) Journal entries reflecting the scheme of reconstruction, (ii) Capital reduction account, (iii) Cash account in the books of Maitri Ltd.

Summarised Balance Sheet of Maitri Ltd. as on 31.3.2012

Liabilities	*₹*	*Assets*	*₹*
Share Capital		*Fixed Assets*	
30,000 Equity shares of ₹ 10 each	*3,00,000*	*Trademarks and Patents*	*1,10,000*
40,000 8% Cumulative Preference shares ₹ 10 each	*4,00,000*	*Goodwill at cost* *Freehold Land*	*36,100* *1,20,000*
Reserves and Surplus		*Freehold Premises*	*2,44,000*
Securities Premium Account	*10,000*	*Plant and Equipment*	*3,20,000*
Profit and Loss Account	*(1,38,400)*	*Investment (marked to market)*	*64,000*
Secured Borrowings			
9% Debentures (₹100) 1,20,000		*Current Assets*	
Accrued Interest 5,400	*1,25,400*	*Inventories:*	

Current liabilities		Raw materials and	
Trade payables	1,20,000	packing materials 60,000	
Vat payable	50,000	Finished goods 16,000	76,000
Temporary bank overdraft	2,23,100	Trade receivables	1,20,000
	10,90,100		10,90,100

***Note**: Preference dividends are in arrears for 4 years.*

The scheme of reconstruction that received the permission of the Court was on the following lines:

(1) The authorized capital of the Company to be re-fixed at ₹ 10 lakhs (preference capital of ₹ 3 lakhs and equity capital of ₹ 7 lakhs). Both classes of shares are of ₹ 10 each.

(2) The preference shares are to be reduced to ₹ 5 each and equity shares reduced by ₹ 3 per share. Post reduction, both classes of shares to be re-consolidated into ₹ 10 shares.

(3) Trade Investments are to be liquidated in open market.

(4) One fresh equity shares of ₹ 10 to be issued for every ₹ 40 of preference dividends in arrears (ignore taxation).

(5) Expenses for the scheme were ₹ 10,000.

(6) The debenture holders took over freehold land at ₹ 2,10,000 and settled the balance after adjusting their dues.

(7) Unprovided contingent liabilities were settled at ₹ 54,000 and a pending insurance claim receivable settled at ₹ 12,500.

(8) The intangible assets were all to be written off along with ₹ 10,000 worth obsolete packing material and 10% of the receivables.

(9) Remaining cash available as a result of the above transactions is to be utilized to pay off the bank overdraft to that extent.

(10) The Equity shareholders agree that they will bring in necessary cash to liquidate the balance outstanding on the overdraft account by subscribing the fresh shares. The equity shares will be issued at par for this purpose.

Solution

(i)

In the books of Maitri Ltd.
Journal Entries

	2012			Dr. ₹	Cr. ₹
1	March 31	Equity Share Capital A/c (₹ 10)	Dr.	3,00,000	
		To Capital Reduction A/c			90,000
		To Equity Share Capital A/c (₹ 7)			2,10,000
		(Being reduction of equity shares of ₹ 10 each to shares of ₹ 7 each as per Reconstruction Scheme dated...)			
2.		8% Cum. Preference Share Capital A/c (₹ 10)	Dr.	4,00,000	
		To Capital Reduction A/c			2,00,000
		To Preference Share Capital A/c (₹ 5)			2,00,000
		(Being reduction of preference shares of ₹ 10 each to shares of ₹ 5 each as per reconstruction scheme)			
3.		Equity Share Capital A/c (30,000 x ₹ 7)	Dr.	2,10,000	
		Preference Share Capital A/c (40,000 x ₹ 5)	Dr.	2,00,000	
		To Equity Share Capital A/c (21,000 x ₹ 10)			2,10,000
		To Preference Share Capital A/c (20,000 x ₹ 10)			2,00,000
		(Being post reduction, both classes of shares reconsolidated into ₹ 10 each)			
4.		Cash Account	Dr.	64,000	
		To Trade Investments			64,000
		(Being trade investments liquidated in the open market)			
5.		Capital Reduction Account	Dr.	32,000	
		To Equity Share Capital Account			32,000
		(Being arrears of preference dividends of 4 years satisfied by the issue of 3,200 equity shares of ₹ 10 each)			
6.		Capital Reduction Account	Dr.	10,000	
		To Cash Account			10,000
		(Being expenses of reconstruction scheme paid in cash)			

7.		9% Debentures Account	Dr.	1,20,000	
		Accrued Interest Account	Dr.	5,400	
		To Debenture holders Account			1,25,400
		(Being amount due to debenture holders)			
8.		Debenture holders Account	Dr.	1,25,400	
		Cash Account (2,10,000 – 1,25,400)	Dr.	84,600	
		To Freehold Land			1,20,000
		To Capital Reduction Account (2,10,000 – 1,20,000)			90,000
		(Being Debenture holders took over freehold land at ₹ 2,10,000 and settled the balance)			
9.		Capital Reduction Account	Dr.	54,000	
		To Cash Account			54,000
		(Being contingent liability of ₹ 54,000 paid)			
10.		Cash Account	Dr.	12,500	
		To Capital Reduction Account			12,500
		(Being pending insurance claim received)			
11.		Capital Reduction Account	Dr.	1,68,100	
		To Trademarks and Patents			1,10,000
		To Goodwill			36,100
		To Raw materials & Packing materials			10,000
		To Trade receivables			12,000
		(Being intangible assets written off along with raw materials and packing materials worth ₹10,000 and 10% of trade receivables)			
12.		Cash Account	Dr.	1,26,000	
		To Equity Share Capital Account			1,26,000
		(Being 12,600 shares issued to existing shareholders)			
13.		Bank Overdraft Account	Dr.	2,23,100	
		To Cash Account			2,23,100
		(Being cash balance utilized to pay off bank overdraft)			
14.		Capital Reduction Account	Dr.	1,28,400	
		To Capital reserve Account			1,28,400
		(Being balance of capital reduction account transferred to capital reserve account)			

(iii) Cash Account

Particulars	₹	Particulars	₹
To Investment	64,000	By Capital reduction (Contingent liability)	54,000
To 9% Debenture holders (2,10,000-1,25,400)	84,600	By Expenses	10,000
To Capital reduction (insurance claim)	12,500	By Temporary bank overdraft - From available cash (64,000+84,600+12,500 -54,000-10,000) 97,100	
To Equity share capital 12,600 shares @ ₹ 10 each	1,26,000	- From proceeds of equity share capital (2,23,100–97,100) 1,26,000	2,23,100
	2,87,100		2,87,100

Note: Shares issued to existing equity shareholders for bringing cash for payment of balance of bank overdraft = ₹ 2,23,100 – ₹ 97,100 = ₹ 1,26,000.

Illustration 13

The Abridged Balance Sheet (Draft) of Cyber Ltd. as on 31st March, 2012 is as under:

Liabilities	₹	*Assets*	₹
24,000, Equity shares of ₹ 10 each	*2,40,000*	*Goodwill*	*5,000*
5000, 8% cumulative preference shares of ₹ 10 each	*50,000*	*Fixed Assets* *Inventories*	*2,57,000* *50,000*
8% Debentures	*1,00,000*	*Trade receivables*	*60,000*
Interest accrued on debentures	*8,000*	*Bank*	*1,000*
Trade payables	*1,00,000*	*Profit & Loss Account*	*1,25,000*
	4,98,000		*4,98,000*

The following scheme is passed and sanctioned by the court:

(i) A new company Mahal Ltd is formed with ₹ 3,00,000, divided into 30,000 Equity shares of ₹ 10 each.

(ii) The new company will acquire the assets and liabilities of Cyber Ltd. on the following terms:

(a) Old company's debentures are paid by similar debentures in new company and for outstanding accrued interest, shares of equal amount are issued at par.

(b) The trade payables are paid for every ₹ 100, ₹ 16 in cash and 10 shares issued at par.

(c) Preference shareholders are to get equal number of equity shares at par. For arrears of dividend amounting to ₹ 12,000, 5 shares are issued at par for each ₹ 100 in full satisfaction.

(d) Equity shareholders are issued one share at par for every three shares held.

(e) Expenses of ₹ 8,000 are to be borne by the new company.

(iii) Current Assets are to be taken at book value (except Inventory, which is to be reduced by ₹ 3,000). Goodwill is to be eliminated, balance of purchase consideration being attributed to fixed assets.

(iv) Remaining shares of the new company are issued to public at par and are fully paid.

You are required to show:

(a) In the old company's books:

(i) Realisation Account

(ii) Equity Shareholder's Account

(b) In the new company's books:

(i) Bank Account

(ii) Summarised Balance Sheet as per the requirements of Schedule-III.

Solution

(a) (i) In the books of Cyber Ltd i.e. Old company's books

Realisation Account

	₹		₹
To Goodwill	5,000	By 8% Debentures	1,00,000
To Fixed assets	2,57,000	By Interest accrued on debentures	8,000
To Inventories	50,000		
To Trade receivables	60,000	By Trade payables	1,00,000
To Bank	1,000	By P Ltd. (Purchase consideration)	1,36,000
To Preference share holders A/c (W.N.3)	6,000	By Equity shareholders (Bal. fig.)	35,000
	3,79,000		3,79,000

(ii) Equity Shareholders' Account

	₹		₹
To Profit & loss A/c	1,25,000	By Equity Share capital	2,40,000
To Equity shares in Mahal Ltd.	80,000		
To Realisation A/c	35,000		
	2,40,000		2,40,000

(b) (i) In the books of Mahal Ltd (New company)

Bank Account

	₹		₹
To Business Purchase To Equity share application & allotment A/c (W.N. 4)	1,000 56,000	By Goodwill (for expenses on absorption) By Trade Payables $\left(\frac{1,00,000}{100}\times 16\right)$ By Balance c/d (Bal. fig.)	8,000 16,000 33,000
	57,000		57,000

(ii) Balance Sheet as on 31st March, 2012

Particulars	*Note No.*	₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
Share Capital	1	3,00,000
(2) Non-Current Liabilities		
Long-term borrowings	2	1,00,000
Total		4,00,000
II. Assets		
(1) Non-current assets		
Fixed assets		
(a) Tangible assets** (W.N.2)		2,52,000
(b) Intangible assets	3	8,000
(2) Current assets		
(a) Inventories		47,000
(b) Trade receivables		60,000
(c) Cash and cash equivalents		33,000
Total		4,00,000

Notes to Accounts

		₹	
1.	Share Capital		
	Authorised share capital		
	30,000 equity shares of ₹ 10 each	3,00,000	

** It is assumed that fixed assets given in the balance sheet of Cyber Ltd. comprises of tangible fixed assets only.

	Issued and Subscribed		
	30,000 shares of ₹ 10 each fully paid up		3,00,000
	(out of the above, 24,400 (W.N.4) shares have been issued for consideration other than cash)		
2.	Long Term Borrowings		
	Secured		
	8% Debentures		1,00,000
3.	Intangible assets		
	Goodwill		8,000

Working Notes:

1. Calculation of Purchase consideration

	₹
Payment to preference shareholders	
5,000 equity shares @ ₹ 10	50,000
For arrears of dividend: (₹ 12,000 x 5 shares / ₹100) @ ₹ 10	6,000
Payment to equity shareholders	
(24,000 shares x 1/3) @ ₹ 10	80,000
Total purchase consideration	1,36,000

2. Calculation of fair value at which fixed assets have been acquired by Mahal Ltd.

Since, the question states that "balance of purchase consideration is being attributed to fixed assets", it is implied that the amount of purchase consideration is equal to the fair value at which the net assets have been acquired.

Therefore, the difference of fair value of net assets (excluding fixed assets) and the purchase consideration is the fair value at which the fixed assets have been acquired.

		₹
Purchase consideration / Net assets		1,36,000
Add: Liabilities:		
8% Debentures		1,08,000
Trade Payables $\left(\frac{1,00,000}{100}\times 16\right)\times\left(\frac{1,00,000}{100}\times 10\times 10\right)$		1,16,000
		3,60,000
Less: Inventory ₹ (50,000- 3,000)	47,000	
Debtors	60,000	
Bank	1,000	(1,08,000)
Fair value at which fixed assets has been acquired		2,52,000

3. Preference shareholders' Account

	₹		₹
To Equity Shares in Mahal Ltd.	56,000	By Preference Share capital	50,000
		By Realisation (Bal. fig.)	6,000
	56,000		56,000

4. Calculation of number of Equity shares issued to public

	Number of shares	
Authorised equity shares		30,000
Less: Equity shares issued for		
Interest accrued on debentures	800	
Trade Payables of Cyber Ltd. $\left(\frac{1,00,000}{100} \times 10 \text{ shares}\right)$	10,000	
Preference shareholders of Cyber Ltd.	5,000	
Arrears of preference dividend $\left(\frac{12,000}{100} \times 5\right)$	600	
Equity shareholders of Cyber Ltd. $\left(\frac{24,000}{3}\right)$	8,000	(24,400)
Number of equity shares issued to public at par for cash		5,600

Illustration 14

The Balance Sheet of X Ltd. as at 31st March, 2014 was as follows:

X Limited

Balance Sheet as at 31.03.2014

	Particulars		*Amount ₹*
I	***Equity and Liabilities***		
1	*Shareholders Fund*		
	Share Capital		
	40000 equity shares of ₹ 100 each fully paid		*40,00,000*
	20000, 10% preference shares of ₹100 each fully paid		*20,00,000*
	Reserve & Surplus		

	(a) Securities Premium Account		*1,50,000*
	(b) Profit & Loss Account		*(23,00,000)*
2.	*Non Current Liabilities*		
	Long Term Borrowings *7% Debentures of ₹ 100 each*		*4,00,000*
3.	*Current Liabilities*		
	Other Current Liabilities		
	(a) Creditors		*10,00,000*
	(b) Loan from Director		*2,00,000*
	Total Liabilities		***54,50,000***
II	***Assets***		
1	*Non Current Assets*		
	Fixed Assets		
	(a) Land & Building	*20,00,000*	
	(b) Plant & Machinery	*12,00,000*	*32,00,000*
	Intangible Assets		
	Goodwill		*4,00,000*
2.	*Current Assets*		
	(a) Debtors	*12,00,000*	
	(b) Stock	*5,00,000*	
	(c) Cash at Bank	*1,50,000*	*18,50,000*
	Total Assets		*54,50,000*

No Dividend on Preference Shares has been paid for last 5 Years.

The following scheme of reorganisation was duly approved by the Court:

(i) Each equity share to be reduced to ₹ 25.

(ii) Each existing Preference Share to be reduced to ₹ 75 and then exchanged for one new 13% Preference Share of ₹ 50 each and one Equity Share of ₹ 25 each.

(iii) Preference Shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity shares of ₹ 25.

(iv) The Debenture Holders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13 % Preference Shares of ₹ 50 each issued at

par. One-fourth (in value) of the Debenture Holders accepted Preference Shares for their claims. The rest were paid in cash.

(v) Contingent Liability of ₹ 2,00,000 is payable which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the Company.

(vi) Goodwill does not have any value in the present. Decrease the value of Plant & Machinery, Stock and Debtors by ₹ 3,00,000; ₹ 1,00,000 and ₹ 2,00,000 respectively. Increase the value of Land & Building to ₹ 25,00,000.

(vii) 50,000 new Equity Shares of ₹ 25 each are to be issued at par payable in full on application. The issue was underwritten for a commission of 4%. Shares were fully taken up.

(viii) Total expenses incurred by the Company in connection with the Scheme excluding underwriting Commission amounted to ₹ 20,000.

Pass necessary Journal Entries to record the above transactions.

Solution

In the books of X Ltd.
Journal Entries

Particulars		*Amount (₹)*	*Amount (₹)*
Equity Share Capital (₹ 100) A/c	Dr.	40,00,000	
To Equity Share Capital (₹ 25) A/c			10,00,000
To Capital Reduction A/c			30,00,000
(Being Equity Shares of ₹ 100 each reduced to ₹ 25 each and balance transferred to Capital Reduction A/c)			
10% Preference Share Capital (₹ 100) A/c	Dr.	20,00,000	
To 10% Preference Share Capital (₹ 75) A/c			15,00,000
To Capital Reduction A/c			5,00,000
(Being Preference Shares of ₹ 100 each reduced to ₹ 75 each and balance transferred to Capital Reduction A/c)			
10% Preference Share Capital (₹ 75) A/c	Dr.	15,00,000	
To 13% Preference Share Capital (₹ 50) A/c			10,00,000
To Equity Share Capital A/c			5,00,000
(Being one new 13% Preference Share of ₹ 50 each and one Equity Share of ₹ 25 each issued against 10% Preference Share of ₹ 75 each)			

Capital Reduction A/c	Dr.	2,00,000	
To Preference Share Dividend Payable A/c			2,00,000
(Being arrear of Preference Share Dividend payable for one year)			
Preference Share Dividend Payable A/c	Dr.	2,00,000	
To Equity Share Capital A/c (₹ 25)			2,00,000
(Being Equity Shares of ₹ 25 each issued for arrears of Preference Share Dividend)			
7% Debenture A/c	Dr.	4,00,000	
To Debenture Holders A/c			4,00,000
(Being balance of 7% Debentures transferred to Debenture Holders A/c)			
Debenture Holders A/c	Dr.	4,00,000	
To 13% Preference Share Capital A/c			1,00,000
To Bank A/c			2,70,000
To Capital Reduction A/c			30,000
(Being 25% of Debenture Holders opted to take 13% Preference Shares at par and remaining took 90% cash payment for their claims)			
Loan from Director	Dr.	2,00,000	
To Provision for Contingent Liability A/c			2,00,000
(Being contingent liability of ₹ 2,00,000 is payable and adjusted against loan from Director A/c)			
Bank A/c	Dr.	12,50,000	
To Equity Share Application & Allotment A/c			12,50,000
(Being application money received on 50,000 Equity Shares @ ₹ 25 each)			
Equity Share Application & Allotment A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being application money transferred to Capital A/c on allotment)			
Underwriting Commission A/c	Dr.	50,000	
To Bank A/c			50,000
(Being underwriting commission paid)			
Land & Building A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being value of land & Building appreciated)			

Expenses on Reconstruction A/c	Dr.	20,000	
To Bank A/c			20,000
(Being payment of expenses on reconstruction)			
Capital Reduction A/c	Dr.	38,30,000	
To Goodwill A/c			4,00,000
To Plant & Machinery A/c			3,00,000
To Stock A/c			1,00,000
To Debtors A/c			2,00,000
To Profit & Loss A/c			23,00,000
To Expenses on Reconstruction A/c			20,000
To Underwriting Commission A/c			50,000
To Capital Reserve A/c			4,60,000
(Being various losses written off and balance of Capital Reduction A/c transferred to Capital Reserve A/c)			

Unit – 5 : Liquidation of Companies

Learning Objectives

After studying this unit, you will be able to

- Prepare Statement of Affairs as per the format prescribed by the Act.
- Draw Deficiency account and will be able to point out the reasons for deficiency.
- Distinguish between preferential payments and over-riding preferential payments.
- Set an order of payment of all obligations.
- Prepare Liquidator's Final Statement of account.

5.1 Statement of Affairs

In the case of a winding up by Court

- a Statement of Affairs of the company in the prescribed form verified by an affidavit, and
- containing particulars stated under section 454(1) of the Companies Act, 1956[1]

has to be submitted to the Official Liquidator. The statement should be submitted by directors and one or more persons who are the manager, secretary or other chief of the company.

In the case of a voluntary winding up either by member or creditors, a Statement of Affairs is required to be submitted.

According to the provisions contained under sections 496 and 508, Liquidator in both the types of winding up are required to hold a general meeting at the end of the first year and at the end of each succeeding year. They must lay before the meeting an account of their acts and dealing together with a statement in the prescribed form and containing prescribed particulars with respect to proceedings in and the position of the liquidation.

The Companies (Court) Rules, 1959 prescribe that the Statement of Affairs should be prepared in Form 57 contained in the Rules. The liquidators also are required to submit annual reports under sections 496 and 508. Such reports are to be presented in Form 153 of the Rules. At the close of the winding up of proceedings in a voluntary liquidation, the liquidators are required to place before the final meeting of shareholders and creditors a consolidated account of the amounts received and paid out by him in Form 156 of the Rules.

The broad lines on which the Statement of Affairs is prepared are the following —

•[1] ***It may be noted that corresponding sections of the Companies Act, 2013 have not been notified till 31st May, 2015. Therefore, relevant Sections of the Companies Act, 1956 are applicable at present. This Unit has been given in line with the provisions of the Companies Act, 1956.***

(1) Include assets on which there is no fixed charge at the value they are expected to realise. Students should note to include calls in arrear but not uncalled capital.

(2) Include assets on which there is a fixed charge. The amount expected to be realised would be compared with the amount due to the creditor concerned. Any **surplus** is to be extended to the other column. A **deficit** (the amount owed to the creditor exceeding the amount realisable from the asset) is to be added to unsecured creditors.

(3) The total of assets in point (1) and any surplus from assets mentioned in point (2) is available for all the creditors (except secured creditors already covered by specifically mortgaged assets).

(4) From the total assets available, the following should be deducted one by one :-

(*i*) Preferential creditors,

(*ii*) Debentures having a floating charge, and

(*iii*) Unsecured creditors.

If a minus balance emerges, there would be deficiency as regards creditors, otherwise there would be a surplus.

(5) The amount of total paid-up capital (giving details of each class of shares) should be added and the figure emerging will be deficiency (or surplus) as regards members.

Note: Statement of affairs should accompany eight lists :

List A Full particulars of every description of property not specifically pledged and included in any other list are to be set forth in this list.

List B Assets specifically pledged and creditors fully or partly secured.

List C Preferential creditors for rates, taxes, salaries, wages and otherwise.

List D List of debenture holders secured by a floating charge.

List E Unsecured creditors.

List F List of preference shareholders.

List G List of equity shareholders.

List H Deficiency or surplus account.

5.2 Deficiency Account

The official liquidator will specify a date for period (minimum three years) beginning with the date on which information is supplied for preparation of an account to explain the deficiency or surplus. On that date either assets would exceed capital plus liabilities, that is, there would be a reserve or there would be a deficit or debit balance in the Profit and Loss Account. The Deficiency account is divided into two parts:

1. The first part starts with the deficit (on the given date) and contains every item that increases deficiency (or reduces surplus such as losses, dividends etc.).
2. The second part starts with the surplus on the given date and includes all profits.

If the total of the first exceeds that of the second, there would be a deficiency to the extent of the difference, and if the total of the second part exceeds that of the first, there would be a surplus.

5.3 Overriding Preferential Payments

The Companies (Amendment) Act, 1985 has introduced section 529A which states that certain dues are to be settled even before the payments to preferential creditors under section 530 in the case of winding up of company. Section 529A states that in the event of winding up a company workmen's dues and debts due to secured creditors, to the extent such debts rank under section 529(1)(c), shall be paid in **priority** to all other debts. The workmen's dues and debts to secured creditors shall be paid in full, unless the assets are insufficient to meet them, in which case they shall be compensated in equal proportions.

It may be noted here that workmen's dues, in relation to a company, means the aggregate of the following sums:

(*i*) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;

(*ii*) all accrued holiday remuneration becoming payable to any workman or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order;

(*iii*) all amounts due in respect of any compensation or liability for compensation under Workmen's Compensation Act, 1923 in respect of death or disablement of any workman of the company;

(*iv*) all sums due to any workman from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the workmen maintained by the company.

5.4 Preferential Creditors

Section 530 specifies the creditors that have to be paid in priority subject to the provisions of section 529A to unsecured creditors or creditor having a floating charge. Such creditors are known as Preferential Creditors. These are the following :

(*a*) All revenues, taxes, cesses and rates, becoming due and payable by the company to the government or to the local authority within 12 months next before the commencement of the winding up.

(*b*) All wages or salaries (including wages payable for time or piece work and salary earned wholly or in part by way of commission) of any employee due for the period not

exceeding 4 months within the twelve months next before commencement of winding up provided the amount payable to one claimant will not exceed ₹ 20,000.[*]

(*c*) All accrued holiday remuneration becoming payable to any employee on account of winding up.

Note: Person who advance money for the purpose of making preferential payments under (*b*) and (*c*) above will be treated as preferential creditors, provided the money is actually so used.

(*d*) Unless the company is being wound up voluntarily for the purpose of reconstruction, all contributions payable during the 12 months next under the Employees State Insurance Act, 1948, or any other law for the time being in force.

(*e*) All sums due as compensation to employees under the Workmen's Compensation Act, 1923.

(*f*) All sums due to any employee from a provident fund, pension fund, gratuity fund or any other fund, for the welfare of the employees maintained by the company.

(*g*) The expenses of any investigation held under section 235 or 237 in so far as they are payable by the company.

Example

A company went into liquidation whose creditors are ₹ 36,000. This amount of ₹ 36,000 includes ₹ 6,000 on account of wages of 15 men at ₹ 100 per month for 4 months, immediately before the date of winding up, ₹ 9,000 being the salaries of 5 employees at ₹ 300 per month for the previous 6 months, Rent for godown for the last six months amounting to ₹ 3,000; Income-tax deducted out of salaries of employees ₹ 1,000. In addition it is estimated that the company would have to pay ₹ 3,000 as compensation to an employees for injuries suffered by him, which was contingent liability not accepted by the company and not included in above said creditors figure.

Find the amount of Preferential Creditors.

Solution

Calculation of Preferential Creditors

	`
Tax deducted at source on salaries	1,000
Wages (15 men for 4 months at ₹ 100 each)	6,000

[*]As per the Companies (Amendment) Act, 1996, the words "exceed such sum as may be notified by the Central Government in the official Gazette" shall be substituted for the words "exceed one thousand rupees" in section 530(2). [Vide Notification G.S.R. 80(E) dated 17-2-1997, the sum payable to any one claimant in relation to wages and salaries shall not exceed ₹ 20,000.]

Salaries (5 men for 4 months at ₹ 300 each)	6,000
Workmen's compensation	3,000
Total	16,000

Note:

(i) Wages or Salaries payable to any employee due for the period not exceeding 4 months within the twelve months next before commencement of winding up subject to maximum 20,000 per claimant are preferential creditors.

(ii) Rent for godown is not included in preferential creditors.

Illustration 1

X Ltd. was ordered to be wound up on March 31st, 2011 on which date its summarised balance sheet was as follows:

Liabilities		*₹*	*Assets*	*₹*
Subscribed Capital :				
10,000 shares of ₹ 100 each		*10,00,000*	*Goodwill*	*1,00,000*
5% Debentures	*1,60,000*		*Building*	*3,50,000*
Interest Accrued	*4,000*	*1,64,000*	*Plant*	*5,50,000*
(Secured by floating			*Fixtures*	*23,000*
charge on all assets)			*Stock*	*38,000*
Bank Overdraft		*25,000*	*Debtors*	*25,000*
(Secured by hypothecation of stock)			*Cash*	*500*
Trade payables		*36,000*	*P & L A/c*	*1,38,500*
Total		*12,25,000*	*Total*	*12,25,000*

The amounts estimated to be realised are : Goodwill ₹ 1,000; Building ₹ 3,00,000; Plant ₹ 5,25,000; Fixtures ₹ 10,000; Stock ₹ 31,000; Debtors ₹ 20,000.

Creditors included ₹ 6,000 on account of wages of 15 men at ₹ 100 per month for 4 months immediately before the date of winding up : ₹ 9,000 being the salaries of 5 employees at ₹ 300 per month for the previous 6 months; Rent for godown for the last six months amounting to ₹ 3,000; Income-tax deducted out of salaries of employees ₹ 1,000 and Directors Fees ₹ 500.

Three years ago, the debit balance in the Profit and Loss Account was ₹ 77,925 and since that date the accounts of the company have shown the following figures:

	Year 31-3-2009 ₹	*Year 31-3-2010 ₹*	*Year 31-3-2011 ₹*
Gross Profit	*65,000*	*45,000*	*40,000*
Wages and Salaries	*40,500*	*36,000*	*34,400*

Electricity and Water Tax	*5,750*	*6,380*	*5,260*
Debentures interest	*8,000*	*8,000*	*8,000*
Bad Debts	*8,540*	*7,600*	*6,700*
Depreciation	*6,700*		
Directors' Fees	*1,000*	*1,000*	*1,000*
Miscellaneous Expenses	*10,500*	*7,265*	*7,980*
Total	*80,990*	*66,245*	*63,340*

In addition it is estimated that the company would have to pay ₹ 5,000 as compensation to an employee for injuries suffered by him which was contingent liability not accepted by the company.

Prepare the Statement of Affairs and the Deficiency account in Form 57 of Companies (Court) Rules, 1959.

Solution:

Statement of Affairs (In liquidation) of X Ltd. on 31 March, 2011

Estimated Realisable value

					₹
Assets not specifically pledged (as per list A)					
Cash					500
Debtors					20,000
Building					3,00,000
Plant					5,25,000
Fixtures					10,000
Goodwill					1,000
					8,56,500
Assets specifically pledged (as per list B)					
	(a)	(b)	(c)	(d)	
	Estimated Realisable Value	Due to secured creditors	Deficiency ranking as unsecured	Surplus carried to the last column	
	₹	₹	₹	₹	
Stock	31,000	25,000	—	6,000	
	Estimated surplus from assets specifically pledged				6,000
	Estimated total assets available for preferential creditors, Debenture holders secured by a floating charge and unsecured creditors (carried forward)				8,62,500
	Summary of Gross Assets :				
	Gross realised value of assets specifically pledged			31,000	
	Other Assets			8,56,500	
	Total			8,87,500	

Liabilities Gross Liabilities			
₹		₹	₹
25,000	Secured creditors (as per list B) to the extent which claims are estimated to be covered by assets specifically pledged		
18,000	Preferential creditors (as per list 'C' Estimated		18,000
	balance of assets available for Debenture holders secured by a floating charge and unsecured creditors)		8,44,500
1,64,000	Debenture holders secured by floating charge (as per list D)		1,64,000
	Estimated surplus as regards debenture holders*		6,80,500
	Unsecured creditors (as per list E)		
	Estimated unsecured balance of claims of creditors partly secured on specific assets brought forward (*c*)	Nil	
	Creditors on Trade Account	16,500	
27,000	Outstanding Expenses	6,500	23,000
2,34,000	Estimated surplus as regards creditors, difference between Gross Assets (D) and Gross Liabilities as per column (E)		6,57,500
	Issued and called up capital : 1000 Equity Shares of ₹ 100 each fully called up as per list (G)		10,00,000
	Estimated deficiency as regards contributories		3,42,500

Note: This must be read subject to the following :

(1) There is no unpaid capital to the called-up.

(2) The estimates are subject to cost of the winding up and to any surplus or deficiency on trading pending realisation of assets.

List H Deficiency Account

Items contributing to deficiency:

(1)	Excess of capital and liabilities over assets three years ago as shown by the balance sheet	77,925
(2)	Net dividends or bonuses declared during the period	Nil
(3)	Net Trading Losses (after charging items shown in Note below) for the same period	60,575
(4)	Losses other than trading losses written off or for	Nil

which provision has been made in the books during the same period

(5) Estimated losses now written off for which provision has been made for the purpose of preparing the statement:

Bad Debts (Debtors)	5,000	
Loss on		
Goodwill	99,000	
Buildings	50,000	
Plant	25,000	
Fixtures	13,000	
Stock	7,000	
Workmen's Compensation	5,000	2,04,000

(6)	Other items contributing to deficiency:	3,42,500
	Items reducing deficiency:	Nil
	Deficiency as shown by the Statement of affairs	3,42,500
	Notes as to net trading profits and losses :	
	Provision for depreciation on fixed assets	6,700
	Charged of Income-tax	Nil
	Interest on Debentures	24,000
	Payment to directors made by the company and required by law to be disclosed in the accounts	3,000
	Balance (being other trading losses)	26,875
		60,575

Particulars of Creditors for expenses	*Unsecured*	*Preferential*
Directors Fees	500	
Income tax on salaries	—	1,000
Rent (not distrained by landlord)	3,000	—
Wages (15 men for 4 months at ₹ 100 each)	—	6,000
Salaries (5 men for 4 months at ₹ 300 each, ₹ 9,000)	3,000	6,000
Workmen's Compensation		5,000
	6,500	18,000

Creditors on trade account are ₹ 16,500 (*i.e.,* ₹ 36,000 less the total of creditors mentioned above, excluding ₹ 5,000 for workmen's compensation).

Illustration 2

From the following particulars, prepare a Statement of Affairs and the Deficiency Account for submission to the official liquidator of the Equipment Ltd., which went into liquidation on December 31, 2012:

	₹	₹
3,000 equity shares of 100 each, ₹ 80 paid-up		*2,40,000*
6% 1,000 preference shares of ₹ 100 each fully paid-up	*1,00,000*	
Less : Calls in arrear	*(5,000)*	*95,000*
5% Debentures having a floating charge on the		
assets (interest paid upto June 30, 2012)		*1,00,000*
Mortgage on Land & Buildings		*80,000*
Trade Creditors		*2,65,500*
Owing for wages		*20,000*
Secretary's salary (@ ₹ 500 p.m.) owing		*3,000*
Managing Director's salary (@ ₹ 1,500 p.m.) owing		*6,000*

Assets	*Estimated to produce*	*Book value*
	₹	₹
Land & Building	*1,30,000*	*1,20,000*
Plant	*1,30,000*	*2,00,000*
Tools	*4,000*	*20,000*
Patents	*30,000*	*50,000*
Stock	*74,000*	*87,000*
Investments in the hands of a		
Bank for an overdraft of ₹ 1,90,000	*1,70,000*	*1,80,000*
Book Debts	*60,000*	*90,000*

On 31st December, 2007 the balance sheet of the company showed a general reserve of ₹ 40,000 accompanied by a debit balance of ₹ 25,000 in the Profit & Loss Account.

In 2008 the company made a profit of ₹ 40,000 and declared a dividend of 10% on equity shares. The company suffered a total loss of ₹ 1,09,000 besides loss of stock due to fire of ₹ 40,000 during 2009, 2010 and 2011. For 2012 accounts were not made.

The cost of winding up is expected to be ₹ 15,000.

Solution

In the matter of the Companies Act, 1956 & In the matter of Equipment Ltd. (in winding up)

Statement of Affairs on 31 December, 2012, the date of winding up

Estimated realisable value

Assets					₹
Assets not specifically pledged (as per list A)					
Trade debtors					60,000
Stock in trade					74,000
Plant					1,30,000
Tools					4,000
Patents					30,000
Unpaid calls					5,000
					3,03,000
Assets specifically pledged (as per list B)					
	Estimated Realisation	*Due to Secured Creditors*	*Deficiency Ranking as Unsecured Creditors*	*Surplus carried to the last column*	
	₹	₹	₹	₹	
Investments	1,70,000	1,90,000	20,000		
Land & Building	1,30,000	80,000		50,000	
	3,00,000	2,70,000			
	Estimated surplus from assets specifically pledged				50,000
	Estimated total assets available for preferential creditors, debenture holders and unsecured creditors				3,53,000
	Summary of Gross Assets:				
	Gross realisable value of - assets specifically charged			3,00,000	
	others assets			3,03,000	
				6,03,000	
	Estimated total assets available for preferential creditors, debenture holders, bank overdraft and unsecured creditors brought forward				3,53,000

Gross Liabilities	Liabilities		
₹		₹	₹
2,50,000	Secured creditors (as per List B) to the extent to which claims are estimated to be covered by assets specifically pledge		
22,000	Preferential creditors as per list C		22,000
	Estimated balance of assets available for Debenture holders, Bank & unsecured creditors		3,31,000
1,02,500	Debenture holders secured by a floating charge as per list D		(1,02,500)
	Surplus as regards debenture holders		2,28,500
	Unsecured creditors as per list E		
	Estimated unsecured balance of claim of creditors partly secured on		
	specific assets	20,000	
	Trade creditors	2,65,500	
2,92,500	Outstanding expenses	7,000	2,92,500
	Estimated deficiency as regards creditors being the difference between gross liabilities and gross assets		64,000
6,67,000			
	Issued & Called up Capital:		
	3,000 Equity shares or ₹ 100 each, ₹ 80 paid	2,40,000	
	6% 1,000 preference shares of ₹ 100 each fully called	1,00,000	3,40,000
	Estimated Deficiency as regards members as per list H		4,04,000

***Note:-** For the purpose of section 530(1)(*b*) of the Companies Act, 1956, the term "employee" shall include officers and other administrative staff members but it shall not include workmen and managing director. In fact, section 530(8)(*bb*) clearly states that the expression 'employee' does not include a workman. Also section 2(26) read with the explanation to section 269 concludes that a managing director is not an ordinary employee and hence he should not be considered as an

employee for the purpose of section 530. The Secretary of a Company, being an officer, is to be included within the definition of 'employee' for the purpose of section 530.

Note: (*i*) The above is subject to cost to winding up estimated at ₹ 15,000 and to any surplus in deficiency on trading realisation of assets.

(*ii*) There are 3,000 shares unpaid @ ₹ 20 per share liable to be called up.

List H - Deficiency Account

				₹
A.	***Item contributing to Deficiency:***			
	1.	Excess of capital & liabilities over assets on 1-1-2010		Nil
	2.	Net dividend & bonuses during the period Jan.-Dec. 2010		29,700
	3.	Net trading losses after charging depreciation, taxation, interest on debentures, etc. during the same period (₹ 1,09,000 + ₹ 1,31,300)		2,40,300
	4.	Losses other than trading losses written off or for which provision has been made in the books during the same period - stock loss.		40,000
	5.	Estimated losses now written off or for which provision has been made for the purpose of preparing the statement :	₹	
		Plant	70,000	
		Tools	16,000	
		Patents	20,000	
		Stock	13,000	
		Investments	10,000	
		Debtors	30,000	1,59,000
	6.	Other reducing items contributing to deficiency		NIL
				4,69,000
B.	**Items reducing Deficiency**			
	7.	Excess of assets over capital and liabilities on 1st Jan. 2008		15,000
	8.	Net trading profit during the period 1st Jan. 2006 to 31st Dec. 2008		40,000
	9.	Profit & Incomes other than trading profit during the same period		
	10.	Other items Deficiency - Profit expected on Land & Building		10,000
				65,000
		Deficiency as shown by the statement of Affairs (A) - (B)		4,69,000
				4,04,000

Working Notes :

(1) Trial Balance to ascertain the amount of loss for 2012

	Dr. ₹	*Cr.* ₹
Land & Building	1,20,000	
Plant	2,00,000	
Tools	20,000	
Patents	50,000	
Stock	87,000	
Investments	1,80,000	
Debtors	90,000	
Equity Capital		2,40,000
6% Preference share capital		95,000
5% Debentures		1,00,000
Interest Outstanding		2,500
Mortgage on Land & Building		80,000
Trade Creditors		2,65,500
Owing for Wages		20,000
Secretary's Salary		3,000
Managing Director's Salary		6,000
Bank Overdraft		1,90,000
Profit & Loss Account on 1-1-2010	1,23,700	
	8,70,700	10,02,000
Loss for the year (balancing figure)	1,31,300	-
	10,02,000	10,02,000

Reserve & Surplus Account

2007		₹	2007		₹
Dec. 31	To Profit & Loss A/c(Transfer)	25,000	Dec. 31	By Balance b/d	40,000
2008			2008		
	To Dividend Equity Preference	24,000	Dec. 31	By Profit for the year	40,000
2009		5,700	2009		
	To Profit & Loss A/c (Loss)	1,09,000	Dec. 31	By Balance c/d	1,23,700
	To Loss of Stock	40,000			
		2,03,700			2,03,700

Illustration 3

X Co. Ltd. went into voluntary liquidation on 1st April, 2011. The following balances are extracted from its books on that date :

	₹		₹
Capital		*Machinery*	*90,000*
24,000 Equity Shares of ₹ 10 each	*2,40,000*	*Leasehold properties*	*1,20,000*
Debentures (Secured by		*Stock*	*3,000*
Floating charge)	*1,50,000*	*Debtors*	*1,50,000*
Bank overdraft	*54,000*	*Investments*	*18,000*
Creditors	*60,000*	*Cash in hand*	*3,000*
		Profit and loss account	*1,20,000*
	5,04,000		*5,04,000*

The following assets are valued as under :

	₹
Machinery	*1,80,000*
Leasehold properties	*2,18,000*
Investments	*12,000*
Stock	*6,000*
Debtors	*1,40,000*

The bank overdraft is secured by deposit of title deeds of leasehold properties. There were preferential creditors amounting ₹ 3,000 which were not included in creditors ₹ 60,000.

Prepare a statement of affairs to be submitted to the meeting of members/creditors.

Solution

Statement of Affairs of X Co. Ltd. on the 1st day of April, 2011

Assets not specifically pledged :	*Estimated realisable values*
Cash in Hand	3,000
Investments	12,000
Debtors	1,40,000
Stock	6,000
Machinery	1,80,000
	3,41,000

Assets specifically pledged :

	(a)	(b)	(c)	(d)
	Estimated Realisable Value	Due to Secured Creditors	Deficiency ranking as unsecured	Surplus carried to last column
	₹	₹	₹	₹
Lease hold property	2,18,000	54,000	—	1,64,000

	Estimated surplus from assets specifically pledged		1,64,000
	Estimated total assets available for preferential creditors, debentures holders secured by floating charge, and unsecured creditors		5,05,000
	Summary of Gross assets		
	Gross realisable value of assets		
	specifically pledged	₹ 2,18,000	
	Other assets	₹ 3,41,000	
	Gross Assets	₹ 5,59,000	
₹	Gross Liabilities(to be deducted from surplus or added to deficiency as the case may be)		
	Secured creditors to the extent to which claims are estimated to be covered by assets		
54,000	Specifically pledged		
3,000	Preferential creditors		3,000
	Estimated balance of assets available for debenture holders secured by a floating charge and unsecured creditors		5,02,000
1,50,000	Debentures		1,50,000
	Estimated surplus as regard debenture holders		3,52,000
60,000	Creditors		60,000
2,67,000			2,92,000
	Estimated surplus as regards creditors [being difference between gross assets (d) and gross liabilities (e)]		
	Issued and called up capital :		
	24,000 equity shares of ₹ 10 each		2,40,000
	Estimated surplus as regard members		52,000

Illustration 4

Insol Ltd. is to be liquidated. Their summarised Balance Sheet as at 30th September, 2012 appears as under:

Liabilities:	*₹*
2,50,000 equity shares of ₹ 10 each	*25,00,000*
Secured debentures (on land and buildings)	*10,00,000*
Unsecured loans	*20,00,000*
Trade creditors	*35,00,000*
	90,00,000
Assets:	
Land and Building	*5,00,000*
Other fixed assets	*20,00,000*
Current assets	*45,00,000*
Profit and Loss A/c	*20,00,000*
	90,00,000
Contingent liabilities are :	
For bills discounted	*1,00,000*
For excise duty demands	*1,50,000*

On investigation, it is found that the contingent liabilities are certain to devolve and that the assets are likely to be realised as follows:—

	₹
Land & Buildings	*11,00,000*
Other fixed assets	*18,00,000*
Current assets	*35,00,000*

Taking the above into account, prepare the statement of affairs.

Solution

Statement of Affairs of Insol Ltd. (in Liquidation)
as on 30th September, 2012

	Estimated Realisable Value (₹)
Assets not specifically pledged:	
(As per list A)	
Other fixed assets	18,00,000

Current assets					35,00,000
					53,00,000
Assets specifically pledged (As per List B)					
	Estimated realisable value	*Due to secured creditors*	*Deficiency*	*Surplus*	
	₹	₹	₹	₹	
Land & Buildings	11,00,000	10,00,000		1,00,000	
	Estimated total assets available to unsecured creditors				54,00,000
	Summary of Gross Assets				
	Gross realisable value of assets specifically pledged			11,00,000	
	Other assets			53,00,000	
	Gross Assets			64,00,000	
Gross liabilities ₹	**Liabilities**				
	Secured Creditors (as per list B) to the extent to which claims are estimated to be covered by assets				
10,00,000	Specifically pledged				
1,50,000	Preferential creditors (as per list C)				1,50,000
					52,50,000
	Unsecured creditors(as per list E)				
20,00,000	Unsecured Loans				20,00,000
35,00,000	Trade creditors				35,00,000
1,00,000	Contingent Liability on Bills Discounted				1,00,000
67,50,000	Estimated deficiency as regards creditors (67,50,000—64,00,000)				3,50,000
	2,50,000 Equity Shares of ₹ 10 each : (as per list G)				25,00,000
	Estimated deficiency as regards members				28,50,000

5.5 Liquidator's Final Statement of Account

In case of voluntary winding up, the statement prepared by the Liquidator showing receipts and payment of cash is called "Liquidator's Statement of Account". In case of compulsory winding up, the statement is known as "Official Liquidator's Final Account". While Preparing the Statement of Account, the following points should be noted :

(*i*) Assets are included in the prescribed order of liquidity.

(*ii*) In case of assets specifically charged in favour of creditors, only the surplus from it, if any, is recognised as "Surplus from Securities".

(*iii*) Net result of trading entered on the receipts side, profits being added and losses being deducted.

(*iv*) Payments made to redeem securities and cost of execution, *i.e.* cost of collecting debts, are deducted from the total receipts.

(v) Payments are made as shown in the following order:

(*a*) Legal Charges;

(*b*) Liquidator's Remuneration;

(*c*) Liquidation Expenses;

(*d*) Debenture holders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);

(*e*) Creditors;

Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge). Unsecured creditors, shareholders for dividends declared but not yet paid;

(*f*) Preference shareholders; and

(*g*) Equity shareholders.

(*vi*) Arrears of dividends on cumulative preference shares should be paid up to the **date of winding up.**

(*vii*) In case of partly paid shares, it should be seen whether any amount is to be **called up** on such shares.

Firstly, the equity shareholders should be called up to pay the necessary amount (not exceeding the amount of **uncalled** capital) if creditors' claims of preference shareholders cannot be satisfied with the amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying off creditors.

(*viii*) The loss suffered by each class of shareholders, *i.e.* the amount that cannot be repaid, should be **proportionate** to the nominal value of the share. The loss per shares have nominal value of ₹ 100, and one set of shareholders has paid ₹ 80 per share and other set has paid ₹ 60 per share. Suitable adjustment will have to be made in cash in such a case; the latter set must contribute ₹ 20 first or the first set must be paid ₹ 20 first.

Illustration 5

M. Ltd. resolved on 31st December 2010 that the company be wound up voluntarily. The following was the trial balance extracted from its books as on that date:

	₹	₹
Equity shares of ₹ 10 each		*2,00,000*
9% Preference shares of ₹ 10 each		*1,00,000*
Plant (less depreciation w/o ₹ 85,000)	*2,15,000*	
Stock in trade	*2,50,000*	
Trade receivables	*55,000*	
Trade payables		*75,000*
Bank balance	*74,000*	
Preliminary Expenses	*6,000*	
Profit & Loss A/c (balance on 1st January, 2010)		*30,000*
Trading loss for the year 2010	*24,000*	
Preference dividend for the year 2010	*6,000*	
Outstanding Expenses (including mortgage interest)		*25,000*
4% Mortgage loan		*2,00,000*
Total	*6,30,000*	*6,30,000*

On 1st January, 2011 the liquidator sold to M. Ltd. Plant for ₹ 2,05,000 and stock in trade for ₹ 2,00,000. The sale was completed in January, 2011 and the consideration satisfied as to ₹ 2,62,200 in cash and as to the balance in 6% Debentures of the purchasing company issued to the liquidator at a premium of 2%.

The remaining steps in the liquidation were as follows:

(1) The liquidator realised ₹ 52,000 out of the book debts and the cost of collection amounted to ₹ 2,000.

(2) The loan mortgage was discharged on 31st January, 2011 along with interest from 31st July, 2010. Creditors were discharged subject to 2% and outstanding expenses excluding mortgage interest were settled for ₹ 2,000;

(3) On 30th June 2011 six month's interest on debentures was received from M. Ltd.

(4) Liquidation expenses amounting to ₹ 3,000 and liquidator's remuneration of 3% on disbursements to members were paid on 30th June, 2011 when:

(a) The preference shareholders were paid out in cash; and

(b) The debentures on M. Ltd. and the balance of cash were distributed ratably among the equity shareholders.

Prepare the Liquidator's Statement of Account showing the distribution.

Solution

M. Ltd. (in liquidation)
Liquidator's Statement of Account from 1st January, 2011 to 30th June, 2011

		₹			₹
Balance at Bank Realisation from :		74,000	Liquidator's remuneration		7302*
Trade receivables M. Ltd. -		52,000	(3% on ₹ 2,43, 398) Liquidation		
₹ 1,40,000 6%			Expenses Loan on		3,000
Debentures	1,42,800		mortgage with		
Cash	2,62,200	4,05,000	Accrued interest**		2,04,000
6 months' interest			Creditors including		
on debentures		4,200	Outstanding Expenses		75,500
Equity shareholders		5,35,200	Return contributors :		
Less: Cost of			6% Preference share-		
Collection of Debts		(2,000)	holders ₹ 10 per share		1,00,000
			6% Debentures	1,42,800	
			Cash (03 P. approx.)		
			per share	598	1,43,398
Total		5,33,200	Total		5,33,200

Illustration 6

Prakash Processors Ltd. went into voluntary liquidation on 31st December, 2010 when their Balance Sheet read as follows:—

Liabilities	***₹***
Issued and subscribed capital :	
5,000 10% cumulative preference shares	
of ₹ 100 each, fully paid	*5,00,000*
2,500 equity shares of ₹ 100 each, ₹ 75 paid	*1,87,500*
7,500 equity shares of ₹ 100 each, ₹ 60 paid	*4,50,000*
15% Debentures secured by a floating charge	*2,50,000*

* 3/103 × 2,50,700 (i.e. ₹ 5,32,000 less payments made to all creditors)

** It is assumed that loan is secured by a floating charge.

Interest outstanding on Debentures	*37,500*
Creditors	*3,18,750*
	17,43,750
Assets	
Land and Building	*2,50,000*
Machinery and Plant	*6,25,000*
Patents	*1,00,000*
Stock	*1,37,500*
Trade receivables	*2,75,000*
Cash at Bank	*75,000*
Profit and Loss A/c	*2,81,250*
	17,43,750

Preference dividends were in arrears for 2 years and the creditors included Preferential creditors of ₹ 38,000.

The assets realised as follows :

Land and Building ₹ 3,00,000; Machinery and Plant ₹ 5,00,000; Patents ₹ 75,000; Stock ₹ 1,50,000; Trade receivables ₹ 2,00,000.

The expenses of liquidation amounted to ₹ 27,250. The liquidator is entitled to a commission of 3% on assets realised except cash. Assuming the final payments including those on debentures is made on 30th June, 2011 show the liquidator's Statement of Account.

Solution

Prakash Processors Limited
Liquidator's Statement of Account

	Receipts		₹		*Payments*		₹
To	Assets realised -			By	Liquidation expenses		27,250
	Bank		75,000	By	Liquidator's Remuneration		36,750
	Other assets:			By	Debenture holders:		
	Land etc.	3,00,000			Debentures	2,50,000	
	Machinery etc.	5,00,000			Interest accrued	37,500	
	Patents	75,000			Interest 1-1-11/30-6-11	18,750	3,06,250
	Stock	1,50,000					
	Trade receivables	2,00,000	12,25,000	By	Preferential creditors		38,000
To	Call on equity shareholders (7,500 × ₹ 2.65) (1)		19,875	By	Unsecured creditors		2,80,750
				By	Preferential shareholders :		
					Preference capital	5,00,000	

				Arrear of Dividend	1,00,000	6,00,000
						12,89,000
			By	Equity shareholders -		
				₹ 12.35 on 2,500 shares		30,875
		13,19,875				13,19,875

Working Notes:

(1) Liquidator's remuneration 12,25,000 × 3/100 =₹ 36,750

(2) As the company is solvent, interest on the debentures will have to be paid for the period 1-1-2011 to 30-6-2011

$$2,50,000 \times \frac{15}{100} \times \frac{1}{2} = ₹\ 18,750$$

(3)

Total equity capital - paid up	₹ 6,37,500
Less : Balance available after payment to unsecured and preference shares (13,00,000 — 12,89,000)	₹ (11,000)
Loss to be born by 10,000 equity shares	₹ 6,26,500
Loss per share	₹ 62.65
Hence, amount of call on ₹ 60 paid share	₹ 2.65
Refund to share on ₹ 75 paid	₹ 12.35

Illustration 7

The following is the Balance Sheet of Confidence Builders Ltd., as at 30th Sept. 2012:

Liabilities		*₹*	*Asset*	*₹*
Share Capital			*Land and Buildings*	*1,20,000*
Issued : 11% Pref. Shares			*Sundry Current Assets*	*3,95,000*
of ₹ 10 each		*1,00,000*	*Profit and Loss Account*	*38,500*
10,000 equity shares of			*Debenture Issue*	
₹ 10 each, fully paid up		*1,00,000*	*expenses not written off*	*2,000*
5,000 equity shares of				
₹ 10 each, ₹ 7.50 per				
share paid up		*37,500*		
13% Debentures		*1,50,000*		
Mortgage Loan		*80,000*		
Bank Overdraft		*30,000*		
Creditors for Trade		*32,000*		

Income-tax arrears :				
(assessment concluded				
in July 2012)				
Assessment year 2010-2011	*21,000*			
Assessment year 2011-2012	*5,000*	*26,000*		
		5,55,500		*5,55,500*

Mortgage loan was secured against land and buildings. Debentures were secured by a floating charge on all the other assets. The company was unable to meet the payments and therefore the debenture holders appointed a Receiver for the Debenture holders brought the land and buildings to auction and realised ₹ 1,50,000. He also took charge of Sundry assets of value of ₹ 2,40,000 and realised ₹ 2,00,000. The Bank Overdraft was secured by a personal guarantee of two of the Directors of the Company and on the Bank raising a demand, the Directors paid off the due from their personal resources. Costs incurred by the Receiver were ₹ 2,000 and by the Liquidator ₹ 2,800. The Receiver was not entitled to any remuneration but the liquidator was to receive 3% fee on the value of assets realised by him. Preference shareholders had not been paid dividend for period after 30th September 2010 and interest for the last half year was due to the debenture holders. Rest of the assets were realised at ₹ 1,00,000.

Prepare the accounts to be submitted by the Receiver and Liquidator.

Solution

Receiver's Receipts and Payments Account

		₹			₹
Sundry Assets realised		2,00,000	Costs of the Receiver		2,000
Surplus received from			Preferential payments		
mortgage			Creditors paid Taxes	-	
Sale Proceeds of land and building	1,50,000		raised within 12 months		26,000
Less: Applied to discharge			Debentures holders Principal	1,50,000	
of mortgage loan	(80,000)	70,000	Interest for half year	9,750	1,59,750
			Surplus transferred		
			to the Liquidator		82,250
		2,70,000			2,70,000

Liquidator's Final Statement of Account

	₹			₹
Surplus received from		Cost of Liquidation		2,800
Receiver	82,250	Remuneration to Liquidator		3,000
Assets Realised	1,00,000	Unsecured Creditors :		
Calls on Contributories :		for Trade	32,000	
On holder of 5,000		Directors for payment		
at the rate of		of Bank O/D		
₹ 2.17 per share	10,850		30,000	62,000
		Preferential Shareholders:		
		Principal	1,00,000	
		Arrears of		
		Dividends	22,000	1,22,000
		Equity shareholder :		
		Return of money to		
		contributors to holders		
		of 10,000 shares at 33		
		paise each		3,300
	1,93,100			1,93,100

Working Note :

Call from party paid shares

Deficit before call from Equity Shares (1,82,250 — 1,89,800)	=	7,550
Notional call on 5,000 shares @ ₹ 2.50 each		12,500
Net balance after notional call		(a) 4,950
No. of shares deemed fully paid		(b) 15,000
Refund on fully paid shares $\frac{4,950}{15,000}$	=	33p
Calls on party paid share (2.50 — 0.33)	=	₹ 2.17

5.6 B List Contributories

The shareholders who transferred partly paid shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not **called** up when the shares were transferred) to pay off such

creditors as existed on the date of transfer of shares and cannot be paid out of the funds otherwise available with the liquidator, provided that the existing shareholders have also failed to pay the amount due on the shares.

Illustration 8

In a liquidation which commenced on April 2, 2011 certain creditors could not receive payments out of the realisation of assets and out of the contributions from "A" list contributories. The following are the details of certain transfers, which took place in 2010 and 2011.

Shareholders	*Number of shares transferred at the date of ceasing to be member*	*Date of ceasing to be member*	*Creditors remaining unpaid and outstanding*
X	*1,500*	*1st March 2010*	*4,000*
A	*1,000*	*1st May 2010*	*6,000*
B	*1,500*	*1st July 2010*	*7,500*
C	*300*	*1st Nov. 2010*	*8,000*
D	*200*	*1st Feb. 2011*	*9,500*

All the shares were ₹ 10 each, ₹ 6 paid up ignoring expenses of and remuneration to liquidators, etc., show the amount to be realised from the various persons listed above.

Solution

X will not be liable since he transferred his shares prior to one year preceding the date of winding up. The amount of ₹ 6,000 outstanding on 1st May 2010 will have to be contributed by A, B, C & D in the ratio of number of shares held by them, *i.e.* in the ratio of 10:15:3:2; thus A will have to contribute ₹ 2,000: B ₹ 3,000, C ₹ 600 and D ₹ 400. Similarly, the further debts incurred between 1st May, 2010 and 1st July 2010, viz. ₹ 1,500 for which A is not liable will be contributed by B, C and D in the ratio of 15:3:2 B will have to contribute ₹ 1,125. C will have to contribute ₹ 255 and D will contribute ₹ 150. The further increase from ₹ 7,500 to ₹ 8,000, viz. ₹ 500 occurring between 1st July and 1st Nov. will be shared by C and D who will be liable for ₹ 300 and ₹ 200 respectively. The increase between 1st Nov. and 1st Feb., is solely the responsibility of D. Against D's liability of ₹ 2,250, he can be called upon to pay ₹ 800, the loss of ₹ 1,450 will have to be suffered by these creditors.

The following statement makes the position clear:

Statement of Liabilities of B list contributors

Creditors Outstanding on the date of ceasing to be member	*A 1,000 Shares ₹*	*B 1,500 Shares ₹*	*C 300 Shares ₹*	*D 200 Shares ₹*	*Amount to be paid to the Creditors ₹*
(1) 6,000	2,000	3,000	600	400	6,000

(2) 1,500	-	1,125	225	150	1,500
(3) 500	-	-	300	200	500
(4) 1,500	-	-	-	1,500	50*
Total (a)	2,000	4,125	1,125	2,250	8,050
(b) maximum liability on shares held	4,000	6,000	1,200	800	
(c) Amount paid (a) or (b) whichever is lower	2,000	4,125	1,125	800	

Summary

- In case of winding up of the company, a statement called Statement of affairs is prepared.
- Deficiency Account is the result of capital plus liabilities exceeding the assets or deficit or debit balance in the profit and loss account.
- Overriding preferential payments are the payments to be made for the workman's dues and debts secured to secured creditors to the extent they rank under section 529(1)(c).
- Preferential creditors have to be paid in priority to unsecured creditors or creditor having a floating charge.
- In case of voluntary winding up, the statement prepared by the Liquidator showing receipts and payment of cash is called "Liquidator's Statement of Account".
- The shareholders who transferred partly paid shares within one year, prior to the date of winding up may be called upon to pay an amount (not exceeding the amount not called up when the shares were transferred) to pay off such creditors as existed on the date of transfer of shares.